BANKING ON A CURVE: HOW TO RESTORE THE COMMUNITY REINVESTMENT ACT

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The federal government's primary financial-regulatory tool for combating wealth inequality is broken. Intended to push banks towards deeper engagement with lower-income and minority communities, the Community Reinvestment Act (CRA) of 1977 has failed to meaningfully reduce the prevalence of "banking deserts" across lower-income communities or to reduce the racial wealth gap. As regulators circulate a proposed overhaul and the prospect of generational reform appears within reach, there is a danger that the CRA's current moment in the sun will pass without the law being substantially improved.

This Article argues that the roots of the CRA's problems are supervisory: bank examiners have severely skewed CRA examination scores to presume success in community lending. The Article documents, for the first time, the extreme grade inflation in examinations, with 96 percent of banks receiving one of the top two ratings. Given the persistence of underinvestment in lower-income and minority communities, that result beggars belief.

As a corrective, banks should be graded on a curve, with a certain percentage of institutions slotted in most grade categories—including, importantly, the categories that prevents banks from pursuing new business opportunities. This reform—which, to maximize its effectiveness, should be enacted in tandem with a collection of other measures designed to discourage regulatory arbitrage—would enable the CRA to fulfill its promise: to expand access to credit, spur investment in overlooked areas, and combat racial inequities through the financial system.

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INTRODUCTION

Expanding access to credit—for instance, to enable borrowers to start businesses, purchase homes, or buy cars to commute to work—is crucial for reducing wealth inequality and improving people's lives.[3] To further that objective, Congress passed the Community Reinvestment Act (CRA) in 1977 to extend for-profit banking into low- and moderate-income areas. The statute's legislative history evinced a particular interest in majority-minority communities, intended as recompense for decades of discriminatory financial policies.[4] The mechanism is simple: the CRA conditions banks' ability to grow on their records of meeting the credit needs of their communities.[5] At the time of its enactment, the statute held incredible promise to lift up lower-income and majority-minority communities, because banks play an essential

[3] *See* Iftekhar Hasan, Roman Horvath, and Jan Mares, *Finance and Wealth Inequality*, 108 J. INT'L MONEY & FIN. 1 (2020).

[4] *See supra* Part I.B.

[5] 12 U.S.C. § 2901(b)

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role, via credit intermediation, in the accumulation of wealth.[6] Indeed, the CRA remains the primary financial law focused on reducing inequality.[7]

Today, however, the United States has little to show for the CRA's forty-five years of operation. Vast "banking deserts" lack access to mainstream financial services, underinvestment in lower-income and minority communities persists, and large racial gaps in household wealth endure.[8] During the mid-2010s, 54 percent of African Americans either did not have a bank account or relied on payday lenders or other "alternative" financial-service providers in the past twelve months.[9] Further, both wealth and income inequality have grown substantially since the statute's passage in

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[6] *See* generally Mehrsa Baradaran, The Color of Money: Black Banks and the Racial Wealth Gap (2017) [hereinafter Baradaran, Color of Money]; Mehrsa Baradaran, How the Other Half Banks: Exclusion, Exploitation, and the Threat to Democracy (2015) [hereinafter Baradaran, How the Other Half Banks].

[7] Other contenders include the Equal Credit Opportunity Act of 1974 and other civil-rights laws that prohibit discrimination in the provision of financial services but do not place affirmative obligations on lenders; the Home Mortgage Disclosure Act of 1975, which mandates disclosure of lending information to assess whether depository institutions are meeting their communities' needs; and the Dodd-Frank Act of 2010, which includes several provisions concerning lower-income, minority, or underserved individuals or communities but is not focused on these groups.

[8] *See* Mehrsa Baradaran, *Jim Crow Credit*, 9 UC IRVINE L. REV. 887, 944 (2019); BARADARAN, COLOR OF MONEY, *supra* note __; Russell D. Kashian, Ran Tao, and Claudia Perez-Valdez, *Banking the Unbanked: Bank Deserts in the United States*, Univ. of Wisc. Working Paper, 2015. Of course, the continued existence of profound inequities in the financial system does not per se mean that the CRA has *failed*. It may be the case that the position of un- and underbanked Americans would be profoundly worse in the absence of this statutory regime. The point is only that the CRA has not made headway in solving these problems, despite hopes that it would.

The CRA also has come under sustained criticism from the banking industry and conservative groups. For instance, the American Bankers Association charges that regulators' implementation of the law is "unpredictable and inconsistent," thus "interfer[ing] with the predictability that banks need." American Bankers Association, *Reforming the Community Reinvestment Act Regulatory Framework,* Comment Letter, November 15, 2018. Others accuse the CRA of "consolidat[ing] the American banking industry into a set of megabanks that were too big to fail,"[8] thus contributing to the global financial crisis. See, e.g., PETER WALLISON, DISSENTING VIEWS, THE FINANCIAL CRISIS INQUIRY COMMISSION FINAL REPORT 441 (2011); but see Raymond H. Brescia, *The Community Reinvestment Act: Guilty, But Not As Charged*, 88 St. John's L. Rev. 1 (2014) (surveying studies finding that the overwhelming majority of financial activity that distressed the system did not concern depository institutions that are subject to the statute).

[9] Susan Burhouse et al., FDIC, 2013 FDIC National Survey of Unbanked and Underbanked Households 4 (Oct. 2014).

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1977.[10] This is especially true for the poorest of the poor, whose share of U.S. wealth has dropped by nearly half in one generation.[11]

Recognizing the need for a course correction,[12] in May 2022 the three federal banking agencies issued a notice of proposed rulemaking to "strengthen and modernize" the CRA.[13] The proposal is massive: nearly seven-hundred pages covering eight substantive areas of reform across twenty-two separate chapters.[14] Its focus is on creating greater variety—and, arguably, more complexity—in bank examinations.[15]

Despite its many merits, this proposal misses the mark. The CRA's primary shortcoming is not, as the agencies' proposed rule suggests, that examinations are suboptimally tailored to banks of different sizes or that they have imperfectly identified their geographic assessment areas.[16] The basic structure of the statute is well-designed to motivate banks to extend credit to, and invest in, underserved areas.

Instead, the root problem is one of bank examination. The CRA tethers banks' interests in growth to their ability to demonstrate lending to, and investment in, communities that they would not otherwise undertake. The statute directs supervisors to assign CRA scores based on banks' ability to demonstrate these activities. Regulators, in turn, are required to use these scores to evaluate banks' applications to open new branches, merge with other banks, and the like.[17] In addition, the statute

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[10] *See, e.g.,* Trends in Income and Wealth Inequality, Pew Research Center, January 9, 2020, available at https://www.pewresearch.org/social-trends/2020/01/09/trends-in-income-and-wealth-inequality/

[11] *Id.* (reporting that the lowest-income Americans held 7% of the nation's wealth in 1983 and 4% in 2016).

[12] Redlining's Ugly Legacy Endures. Here's How to Fight It, Bloomberg.com, August 30, 2021.

[13] Office of the Comptroller of the Currency, News Release, Agencies Issue Joint Proposal to Strengthen and Modernize Community Reinvestment Act Regulations, May 5, 2022. These three banking regulatory agencies are the Board of Governors of the Federal Reserve System (the Fed), Office of Comptroller of the Currency (OCC), and Federal Deposit Insurance Corporation (FDIC).

[14] Notice of Proposed Rulemaking, 12 C.F.R. part 25, RIN 1557-AF15, May 5, 2022, available at https://www.occ.treas.gov/topics/consumers-and-communities/cra/index-cra.html

[15] For instance, the banking regulators propose the following changes: including by modernizing regulatory relationships with mobile and online banking, *Id.* at § XI; treating banks differently according to size and activity, *id.* at § IX; reducing data-porting burdens, *id.* at § XI; and integrating CRA-related complaints and CRA exams. *id.* at § XX.

[16] Neither is it, as some critics have charged, that the fundamental premise of government-supported community reinvestment is flawed. *See, e.g.,* Matthew Adams, *Don't Just "Modernize" Community Reinvestment Act, Repeal It*, COMPETITIVE ENTERPRISE INSTITUTE BLOG, December 13, 2019, available at https://cei.org/blog/dont-just-modernize-community-reinvestment-act-repeal-it/

[17] 12 U.S.C.§§ 2901(b), 2903(a).

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mandates publication of these scores.[18] In so doing, it grants community groups access to information concerning banks' community-lending activities, and thus encourages banks to meet their obligations or face opposition from these groups. Accordingly, the scores that CRA examiners assign are at the absolute heart of the statutory scheme; a lack of meaningful variation in examination scores would frustrate the law's purpose.

Despite the centrality of meaningful variance in scores to achieving the law's objectives, CRA examiners rate a miniscule fraction of banks as less than satisfactory. In 2022, over 96 percent of banks received the top two (of four) ratings on CRA examinations—the very scores needed to ensure that supervisors do not block expansion of their banking businesses. Further, the fraction of banks receiving low scores has declined precipitously during the past several decades. In other words, examination outcomes have become more equal as economic outcomes have become less equal.[19]

This Article documents, for the first time, this extreme grade inflation in CRA scores. Using over seventy-eight thousand CRA examinations spanning thirty-one years, other novel data, historical documents, and legal analysis, we show that grade inflation and lack of variation in examination outcomes debilitate the CRA. For one, regulators cannot meaningfully distinguish between different banks' applications to expand when the overwhelming majority of banks receive the same grades. Neither can concerned citizens and businesses use the ratings to direct their dollars to firms that invest in low- and moderate-income communities. Likewise, community groups cannot know on which banks to focus when virtually every bank is rated highly. Finally, bankers cannot reasonably be expected to prioritize boosting community lending when examiners consistently, if artificially, tell them that their efforts are "satisfactory" or better.

We argue for a better approach: banks should be graded on a curve. Curved grading is ubiquitous in assessments of all kinds. For one, students are graded on curves to combat "grade inflation."[20] Government actors apply a similar logic when the fund grants or award contracts based on fixed percentages.[21] In the CRA context,

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[18] Id. at § 2906(b).

[19] *See* Aditya Aladangady and Akila Forde, *Wealth Inequality and the Racial Wealth Gap*, FED NOTES, Oct. 22, 2021, https://www.federalreserve.gov/econres/notes/feds-notes/wealth-inequality-and-the-racial-wealth-gap-20211022.htm.

[20] *See* Part III.A, *infra*.

[21] *See, e.g.*, National Institute of Mental Health, Grant Writing & Approval Process, https://www.nimh.nih.gov/funding/grant-writing-and-application-process/what-your-score-means.

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curved grading would require the federal banking regulators to mandate that their bank examiners assign a fixed percentage of banks to various ratings on the CRA's scale.[22]

To be clear, although grading banks on a curve would enable the CRA to better realize its extraordinary promise, we do not claim that this reform would provide some global panacea. Other substantial challenges that CRA reformers should tackle include a current regulatory structure that encourages gerrymandered community definitions and charter shopping, as well as the growth of non-bank lenders that lie outside of the CRA's scope. Accordingly, we also propose redefining the community standard, introducing tradeable CRA credits, and closing the credit union and nonbank loopholes.[23]

As we will show, this suite of proposals is deeply intertwined with our proposal to grade on a curve. For one, any regulatory reform that addresses these issues but does not implement a curved grade distribution will leave the CRA relatively toothless. Conversely, grading on a curve *without* also implementing these other reforms would encourage some banks to take greater advantage of existing loopholes to avoid be subject to newly invigorated CRA examinations, and present other banks with failing scores with an impossible set of constraints. Our complementary proposals address both challenges.

The Article proceeds as follows. Part I details lawmakers' motivations and the historical context behind the CRA's enactment. This Part then describes how the CRA has endured for forty-five years, through multiple rounds of amendments, while the problems that its backers aimed to redress endure. It emphasizes that the problems of inequality in the United States—problems that have only become more entrenched since the CRA's passage in 1977—require something more than the statute has provided to date.

Part II introduces original analysis of the distribution of CRA grades over time and across agencies, with particular attention to the long-term inflationary trend in the distribution of scores. This Part also demonstrates that alternative distributions are readily available. Namely, when investors evaluate whether to purchase a bank's bonds, they utilize Standard & Poor's credit scores with a wide distribution; and when retail customers consider where to bank, they utilize Yelp scores with an even wider spread. The implication is that the audiences for these scores—i.e., investors and retail bank customers, respectively—are comfortable understanding and using scores with wide distributions when evaluating banks. We should expect no less from the audiences for

[22] Nonetheless, we also recommend that regulators retain discussion to assign banks to the fourth category, *Substantial Noncompliance*, for reasons we discuss in Part III, *infra*.

[23] *See* Part III.D, *infra*.

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CRA scores: regulators assessing banks' applications to expand, members of the public deciding to become customers of a bank that reflects their values, and community groups deciding which banks to support or oppose.

Part III presents our suite of policy proposals, including those supplementary proposals meant to make our core suggestion, that banks be graded on a curve for CRA exams, easier to implement and more workable for all constituencies. We conclude by noting the potential that the CRA offers and the genuine fork in the road that regulators, legislators, bankers, and society in general face together in this generational moment to reform this vital statute.

I. THE PROMISE OF COMMUNITY REINVESTMENT

The Community Reinvestment Act of 1977 represented a culmination of a suite of antidiscrimination laws in housing and finance.[24] Building on the momentum of the civil rights era, and with Jimmy Carter as the newly elected Democratic President, Congress charged the banking regulators with using their supervisory authority to "encourage [banks] too help meet the credit needs of the local communities in which they are chartered."[25] That mandate held special force for lending in low- and moderate-income communities and in communities in which the majority of residents are racial minorities.

The model Congress followed with the CRA was different than what had come before. In a series of landmark civil rights laws enacted in the 1960s and 1970s, Congress prohibited racial discrimination,[26] disclose practices associated with such discrimination,[27] and enforce violations of these laws through coordinated effort.[28] By contrast, the CRA contemplated affirmative steps to expand lending to underserved communities by conditioning bank expansion on these efforts. The statute was written to create profitable opportunities for banks in areas where community leaders would welcome them. It also created opportunities for these same community leaders to evaluate whether banks had indeed acted according to those commitments.

[24] The best overview of these debates is Rebecca K. Marchiel, After Redlining: The Urban Reinvestment Movement in the Era of Financial Deregulation (2020).

[25] 12 U.S.C. § 2903(b)

[26] E.g., Civil Rights Act of 1964, 42 U.S.C. § 2000d et seq.

[27] The Home Mortgage Disclosure Act, 12 U.S.C. § 2801 et seq.

[28] The Fair Housing Act was passed as part of the Civil Rights Act of 1968, Pub. L. 90-284, 82 Stat. 73 (1968).

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In this Part, we take a tour through the history of the CRA and its regulatory and legislative changes, largely stunted since 2005 but on the horizon in 2022. Our conclusion is stark: despite some meaningful steps in the right direction, the CRA has failed to deliver on its promise, as access to credit and other banking services continues to be highly stratified and wealth inequality continues to grow.

A. Path to Enactment

i. Pre-History

The problems that the CRA was designed to address—the exclusion of low-income and especially minority borrowers from the U.S. economic system—are older than the American republic.[29] The New Deal, though, is the best place to start to understand the specific role that the government and banks played in creating a situation of such uneven availability of credit and financial services in the United States.[30] In June 1933, as part of the legislative torrent during the Roosevelt administration's "First One Hundred Days," Congress created the Home Owners' Loan Corporation (HOLC), a government-sponsored enterprise designed "to refinance home mortgages [and] to extend relief to the owners of homes who occupy them who are unable to amortize their debt elsewhere."[31] In its first two years of operation, the HOLC initiated over 1 million loans to homeowners at or near default.[32]

During this early phase, the HOLC appeared not to utilize race as a criterion in evaluating applications for credit. This changed in 1935, when the HOLC produced maps of 239 cities that sorted each city into four zones.[33] The fourth zone—comprised overwhelming of majority-Black and majority-Hispanic neighborhoods—was

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[29] *See* Baradaran, The Color of Money, *supra* note __.

[30] A recent article by LaDale C. Winling and Todd M. Michney challenges this public-private distinction and seeks to situate debates about redlining into broader intellectual currents that passed easily between the public and private sectors. See Winling & Michney, *The Roots of Redlining: Academic, Governmental, and Professional Networks in the Making of the New Deal Lending Regime*, 108 J. AM. HIST. 42 (2021).

[31] Home Owners' Loan Act of 1933. Pub. L. 73–43, 48 Stat. 128' *see also* Josh Silver, The Purpose and Design of the Community Reinvestment Act (CRA): An Examination of the 1977 Hearings and Passage of the CRA, 72 CONF. OF CONSUMER FIN. L. Q. REP. (2019).

[32] Amy E. Hillier, Redlining and the Home Owners' Loan Corporation, J. URBAN HIST (2003).

[33] The iconic account of the HOLC process was documented in Kenneth Jackson, Crabgrass Frontier: The Suburbanization of the United States (1987).

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considered "hazardous" for lending and shaded in red. Private banks subsequently blocked these communities' access to mortgages and other loan products.[34] The phenomenon of "redlining"—i.e., withholding credit and investment from majority-minority areas shaded red on the HOLC's maps—was borne of these practices.[35]

The Federal Housing Administration (FHA), founded in 1934, built on the HOLC maps and philosophy to severely restrict the housing support it would offer in minority neighborhoods. In 1938, for example, its training manual included the instruction that "[a]reas surrounding a location are to be investigated to determine whether incompatible racial and social groups are present, for the purpose of making a prediction regarding the probability of the location being invaded by such groups." It concluded: "A change in social or racial occupancy generally contributes to instability and a decline in values."[36] By 1959, only 2% of all FHA loans went to minority households.[37] In 1961, the U.S. Commission on Civil Rights reported that lending to minorities varied from absolute exclusion in some parts of the country to requiring "excessively high downpayments" in others.[38] Racial discrimination in the allocation of housing benefits—a cornerstone of government policy since the New Deal—was ubiquitous.[39]

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[34] Whether banks' decisions to withhold credit are directly attributable to their reliance on the HOLC maps or indirectly, as other government actors relied on the maps, is in dispute. Indeed, there is a vibrant debate about the meaning and importance of these maps. Hillier has illustrated that these maps could not have been the basis of future redlining, which was largely instigated by the FHA and by the private banks themselves, working in concert. Hillier, *supra* note XX. Glock suggests that, despite the FHA's earlier discriminatory practices, their own lending patterns lent more aggressively in majority-minority neighborhoods. Judge Glock, *How the Federal Housing Administration Tried to Save America's Cities, 1934-1960,* 28 J. POL'Y HIST 290 (2016). Freund argues—and Winling & Michney, *supra* note XX later extend—the idea that the direct origin of the "redlined" maps is of lesser importance than the ecosystem that supported all three sets of actors (HOLC, FHA, and private institutions) to agree together that the majority-minority neighborhoods should be excluded from private lending. DAVID M.P. FREUND, COLORED PROPERTY: STATE POLICY AND WHITE RACIAL POLITICS IN SUBURBAN AMERICA (2007). For our purposes, the point is simple: there was an extremely well documented practice, throughout the United States, whereby private and public actors sought to exclude low- and moderate-income neighborhoods—very often majority minority neighborhoods—from credit allocation.

[35] Jean Pogge, *Reinvestment in Chicago Neighborhoods*, in GREGORY SQUIRES, ED., FROM REDLINING TO REINVESTMENT (1992, 134)

[36] US Federal Housing Administration, Underwriting Manual (1938, 937)

[37] Keeanga-Yamahtta Taylor, Race for Profit: How Banks and the Real Estate Industry Undermined Black Homeownership 35 (2019)

[38] US Commission on Civil Rights, Housing: 1961 Report 30 (1961)

[39] Id.

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ii. Development

While racial discrimination and its prohibition were squarely if unevenly on congressional agendas during the Kennedy Administration,[40] the specific problem of the lack of financial services in low-to-moderate-income and majority-minority communities did not become a pressing national concern until the end of the second Johnson Administration.[41]

The year 1967 marked a turning point. That year saw urban unrest in dozens of cities nationwide.[42] Although the causes of this so-called "long, hot summer" were multiple, failures of federal housing policy and private banks were major factors.[43] This tumult prompted two influential government reports—the Kerner Commission and the President's Committee on Urban Housing—about the state of housing and, relatedly, the state of housing finance, in the United States.[44] These reports reached strikingly similar conclusions: that these socials could be traced in substantial part to residential segregation. In the ringing words of the introduction to the Kerner Commission's report, "What white Americans have never fully understood – but what the Negro can never forget – is that white society is deeply implicated in the ghetto. White institutions created it, white institutions maintain it, and white society condones it."[45]

Congress reacted to these reports by passing the Civil Rights Act of 1968, which included the Fair Housing Act.[46] Racial discrimination in housing had been illegal for over a century prior to 1968,[47] but in the absence of a federal enforcement

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[40] Daniel Stevens, Public Opinion and Public Policy: The Case of Kennedy and Civil Rights, 32 PRES. STUD. Q. 111 (2002)

[41] *See* Julian Zelizer, The Fierce Urgency of Now: Lyndon Johnson, Congress, and the Battle for the Great Society (2015).

[42] *See, e.g.*, Lyndon Johnson, *Address After Ordering Federal Troops to Detroit, Michigan*, July 24, 1967, available at https://millercenter.org/the-presidency/presidential-speeches/july-24-1967-address-after-ordering-federal-troops-detroit

[43] TAYLOR, *supra* note 37.

[44] A Decent Home: The Report of the President's Committee on Urban Housing (1968); Report of the National Advisory Commission on Civil Disorders (1968) (hereinafter "Kerner Commission").

[45] KERNER COMMISSION, *supra* note __, at 1.

[46] Titles VIII and IX of the Civil Rights Act of 1968, Pub. L. 90-284, 82 Stat. 73.

[47] Civil Rights Act of 1866, 14 Stat. 27-30.

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mechanism, that prohibition was a dead letter.[48] The Fair Housing Act provided that mechanism.[49]

In 1974, in response to allegations of sex discrimination,[50] Congress passed the Equal Credit Opportunity Act to expand its prohibition of discriminatory lending to "any aspect of a credit transaction."[51] Two years later, Congress amended the ECOA to include a longer list of protected categories, including "race, color, religion, national origin, sex or marital status, or age."[52]

For purposes of disclosing actual bank practices that had long before been wrapped in secrecy, the most significant of all of these pre-CRA statutes was the Home Mortgage Disclosure Act of 1975.[53] In it, Congress identified the statutory purpose "to provide the citizens and public officials of the United States with sufficient information to enable them to determine whether depository institutions are filling their obligations to serve the housing needs of the communities and neighborhoods in which they are located."[54] Because, as Congress described the situation, "some depository institutions have sometimes contributed to the decline of certain geographic areas by their failure . . . to provide adequate home financing to qualified applicants on reasonable terms and conditions," the public should have the power to discover what, exactly, was going on.[55]

HMDA was a remarkable departure from opacity norms in the banking sector. The statute gave citizens, politicians, activists, and anyone else the data they needed to prove the case of racial exclusion that banks had so long denied and bank regulators had so long contested as unnecessary and separate from their core mission.[56] But more "was at stake than mere information," in the words of historian Rebecca Marchiel.[57] As Senator William Proxmire (D-WI), the chief sponsor of the legislation, explained his intent in the hearings that would produce this legislation, banks were all too eager to "welcome business [from lower-income and minority customers] at the deposit

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[48] TAYLOR, *supra* note 37

[49] 42 U.S.C. §§ 3612-3614 (enforcement provisions of the Fair Housing Act as applicable, respectively, to the Secretary of Housing and Urban Development, private litigants, and the Department of Justice).

[50] J. Gelb and Marian L. Palley, Women and Interest Group Politics: A Comparative Analysis of Federal Decision-Making, 41 J. POL. 362 (1979).

[51] 12 U.S.C. § 1691c(b)

[52] 15 U.S.C. § 1691.

[53] 12 U.S.C. § 2801 et seq.

[54] HDMA Sec 302

[55] 12 U.S.C. § 2801 (a)

[56] MARCIEL, *supra* note 24 at 122.

[57] *Id.*

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window, . . . but when it comes time for the dream of homeownership, when they try to get a mortgage loan, they find they live on the wrong side of the tracks."[58] The disclosures that HMDA produced were aimed to provide community leaders with the information necessary to right this wrong.

By the late 1970s, the extant statutory framework articulated two broad goals: to forbid, via enforcement, racial discrimination and to force disclosure of banks' lending practices. According to historian Keeanga-Yamahtta Taylor, the enforcement mechanisms were ineffective, built as they were on third-party participation that worked to sabotage these efforts more than implement them.[59] The disclosure requirements, however, were more consequential, galvanizing community activists into a growing movement advocating for bank reinvestment in underserved areas. For that movement, Senator Proxmire had cogently articulated the problem to be solved during the aforementioned HMDA hearings: banks were willing to take deposits from lower-income and majority-minority areas, but offered residents of these areas exceedingly few loans in return.

iii. Enactment

The legislation prior to the passage of the CRA, although important, did not come close to meaningfully redressing generations of racial discrimination and financial exclusion. What these communities needed was not just a new, nondiscriminatory start; they needed some kind of affirmative remedy to redress the problems of those decades past.

Congress passed the CRA, under Senator Proxmire's leadership, in 1977. The law offered a fundamentally different approach to racial exclusion and discrimination in the banking and housing sectors.[60] The key innovation was in the architecture of lending that the CRA created. At the time of its passage, as Professor Marchiel argues in her definitive history of reinvestment activism, the key approach to solving the problems of inner cities was called "urban renewal," or a "federal strategy to remove 'blight' by empowering city agencies to clear 'slums' and build modern structures in

[58] Home Mortgage Disclosure Act of 1975, Hearing before the Committee on Banking, Housing and Urban Affairs.

[59] TAYLOR, *supra* note 37. at 257.

[60] The CRA is codified in 12 U.S.C. § 2901. For overviews of the CRA's passage, see MARCIEL, *supra* note 24; Michael Barr, *Credit Where It Counts: The CRA and Its Critics*, 80 NYU L. REV. 514, 524 (2005).

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their place."[61] Unlike other efforts, the CRA was not meant for "clearing" those parts of the cities that had been ignored by private banks and the federal regulators that supported them.[62] The CRA was an activist-led partnership *with* banks that would create incentives, positive and negative, for banks to deploy lending back into those neighborhoods once again.[63]

Many bankers supported the general principles of the legislation. One president of a savings bank "heartily concur[red]" with the premise that financial institutions have a "primary and continuing responsibility to the community" in which they operate, including in the extension of credit and not just the acceptance of deposits.[64] Another praised Congress for the effort, identifying financial institutions as possessing "special characteristics" that can "serve as a pivotal point in the fight against spiraling neighborhood deterioration."[65] Other bankers disagreed with the need for legislation, viewing the measure as imposing "significant additional burden of administrative processes and paperwork" and reflected a "serious misunderstanding of how the nation's financial system functions to meet the credit needs of all communities."[66]

Regulators, too, expressed misgivings. The Comptroller of the Currency—the regulator and supervisor of banks with a national charter, including the largest commercial banks in the country—argued that "in general, a bank serves its depositors best when it invests prudently in its community."[67] He also argued that the Comptroller's robust "special consumer examination" already covered what was necessary to resolve the concerns of "community revitalization."[68] Other banking regulators agreed. According to Fed Chair Arthur Burns, the Federal Reserve already encouraged banks to meet "the credit needs of their communities to the extent this is consistent with safe and sound operations." Thus, no new legislation was required.[69] Similarly, FDIC Chairman Robert Barnett wrote that while the FDIC "fully support[ed] the objectives" of the proposed legislation, the approach considered

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[61] Marchiel, *supra* note 24, at 5.
[62] Id.
[63] Id.
[64] Statement of Todd Cooke, President of the Philadelphia Saving Fund Society, Hearings on the CRA 1977, page 291.
[65] Statement of A.A. Milligan, President-elect, American Bankers Association, Hearings on the CRA 1977, page 296.
[66] Id. at 314.
[67] Statement of Robert Bloom, Acting Comptroller of the Currency, Hearings on the CRA 1977, page 12.
[68] Id.
[69] Id. at 14.

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would be "piecemeal" and create an "unnecessary reporting burden on financial institutions which would largely be duplicative of requirements already in effect."[70]

The argument that bankers and regulators already pursued appropriate reinvestment fails on its own terms. Even assuming bankers good intentions not to racially discriminate, the problem of community reinvestment remained. The issue was not only how to prevent discrimination in specific instances, a nontrivial goal that continues to plague actors in the financial system. The problem included, at least in part, the challenge to shift incentives to resolve what former Fed Chair Ben Bernanke later called CRA's "first-mover problem."[71] Even in the absence of racial discrimination, banks would not immediately rush into previously neglected areas with loan offers. For one, lower-income areas are more difficult to effectively appraise given lower turnover in housing relative to wealthier areas.[72] Underwriting processes also are harder to bureaucratize given the newness of the lending in these areas.[73] In other words, because lending in these communities had not yet taken root, there were initial barriers to entry that would be expensive for the first banks to break through. Given these high initial costs, the first bank to move into the area would find such lending more costly than later entrants that could free ride on the first mover's resolution of these logistical difficulties.[74]

The CRA aimed to resolve this precise problem. The law formalized a requirement for all federal bank examiners to take community needs into consideration and then went further: if banks wanted to grow, bank regulators needed to assess community reinvestment as part of the approval process.[75] The chief innovation of the CRA, then, was to tie the banks' interest in growth to its ability to reinvest in these communities.[76]

Given its weighty objectives, it is remarkable how slim the CRA was in its original form. Passed as part of the larger housing and community-development law,[77] the structure of the original CRA was just two pages and consisted primarily of an

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[70] Statement of Robert Barnett, Chairman of the Federal Deposit Insurance Corporation, Hearings on the CRA 1977, page 16.

[71] Ben S. Bernanke, *The Community Reinvestment Act: Its Evolution and New Challenges*, Speech Before the Community Affairs Research Conference, Washington, DC, March 30, 2007.

[72] Id.

[73] Id.

[74] *See* David C. Ling and Susan M. Wachter, *Information Externalities and Home Mortgage Underwriting*, 44 J. URBAN ECON. 317 (1998); William W. Lang and Leonard I. Nakamura, *A Model of Redlining*, 33 J. URBAN ECON. 223 (1993); Barr *supra* note 60.

[75] 12 U.S.C. § 2903

[76] *See* Barr, *supra* note 60

[77] Housing and Community Development Act of 1977, Pub. L. 95-128m 91 Stat. 1111 (1977).

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open-ended charge to federal bank examiners. Congress concluded that "regulated financial institutions are required by law to demonstrate that their deposit facilities serve the convenience and needs of the communities in which they are chartered to do business."[78] In light of that requirement, the relevant examiners were instructed "to use [their] authority when examining financial institutions [] to encourage such institutions to help meet the credit needs of the local communities in which they are chartered, consistent with the safe and sound operation of such institutions."[79]

These examinations would include an assessment of each bank's "record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods" and to "take such record into account in its evaluation of an application for a deposit facility by such institution."[80] The statute excludes credit unions and non-depository institutions engaged in lending from CRA coverage.[81]

The CRA gets its teeth from the mandate that regulators take a bank's CRA score into account when evaluating that bank's application for a new deposit facility. The statute defines "deposit facilities" as including everything from a new bank charter, a merger or acquisition of another bank, deposit insurance, a new branch, the relocation of a branch, and more.[82] Essentially, Congress determined that the banks' ability to grow depended on their ability to reinvest.

What the CRA lacked in 1977, however, was more concrete specification for how these two aims—bank growth and community reinvestment—would interact. In a longstanding pattern in bank supervision,[83] Congress left this specific question to the federal bank regulators and supervisors to decide.

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[78] 12 U.S.C. § 2901(a)(1). This was a fair statement of the chartering and quasi-chartering law as it existed at the time. By quasi-chartering, we refer to the legal requirements for otherwise chartered depository institutions to apply for (and receive) deposit insurance, administered by the FDIC, and access to master accounts, administered by the Federal Reserve. For a critical overview of this practice, see Peter Conti-Brown, *The Fed Wants To Veto State Banking Authorities. But Is That Legal?* Brookings Institution, November 14, 2018.

[79] 12 U.S.C. § 2901(b).

[80] Id. § 2903(a)(2).

[81] Id. at § 2902 (restricting application to "insured depository institutions"); 12 U.S.C. § 1813 (defining "insured depository institutions").

[82] Id. at § 2902(3).

[83] *See* Peter Conti-Brown & Sean H. Vanatta, The Banker's Thumb: A History of Bank Supervision in America, forthcoming Princeton University Press.

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B. Evolution

Perhaps because the statutory language was so scant and hortatory, or perhaps because the regulators themselves did not want to prioritize this entire apparatus, regulators did little with their new CRA authority during its first decade.[84] Initially, implementation of the CRA focused on the process that banks must undertake to qualify for merger and expansion approval, rather than specific lending outcomes.[85] This process-oriented approach meant that the law was almost never invoked as the basis for denying mergers.[86] Shockingly, the first merger denial based on a bank's failure to meet its CRA obligations did not occur until 1989.[87] Banking regulators were similarly unwilling to use other tools that the CRA provided. During the initial decade after the statute's passage, of the 40,000 times that banks requested approval for growth, only eight were rejected on CRA grounds.[88]

Banking regulators' failure to prioritize CRA enforcement caused Senator Proxmire, the Act's original author, to lament in 1989 that "[r]edlining hasn't disappeared. Neighborhoods are still starving for credit. Too many bankers still think the grass is greener elsewhere."[89] He also had a specific, stinging critique for the bank regulatory agencies:

> Regulators seem to think that we're all living in Lake Wobegone. Like the children of the fictional village, U.S. lenders are all above average. Almost all get high ratings year after year and almost none are ever held back. And I ask myself, how is it that so many neighborhoods are continuing to fail while so many lending institutions are continuing to pass?[90]

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[84] *See* Barr, *supra* note 60 at 524.

[85] *See* Fishbein, *supra* note 88.

[86] *Id.*

[87] *Id.*

[88] *Id.* at 297.

[89] Discrimination in Home Mortgage Lending: Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs, 101st Cong., 1st Sess. 7 (1989) ("Proxmire Hearings"). See also Fishbein, *supra* note 88.

[90] Proxmire Hearings, *id.*

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Lake Wobegone, Garrison Keillor's fictional town in his long-running radio show *Prairie Home Companion*, was a place where "all the women are strong, all the men are good looking, and all the children are above average."[91] The problem with the CRA, then, was not only that the banks weren't fulfilling its objectives. It also was the bank supervisors were not doing so either: they conceived of a Lake Wobegone-like financial community where "lenders are all above average."

Frustrated with bank supervisors' failure to live up to Congress's aims in enacting the CRA, Congress made two key changes. First, in 1989—as part of the omnibus Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA),[92] Congress required regulators to "disclose[] to the public" each regulated financial institution's CRA score.[93] This disclosure requirement constituted a marked departure from regulatory tradition that casts a heavy shroud of secrecy over nearly every part of the bank examination process.[94]

FIRREA also replaced the regulatory standard of five numerical scores with a new statutory system of four qualitative scores: *outstanding*, *satisfactory*, *needs to improve*, and *substantially noncompliant*.[95] In so doing, the bill's sponsors intended the combination of qualitative scores and public disclosure to change examiners' behavior.[96]

Regulators responded by issuing a joint statement emphasizing that the CRA examination process would require banks to place greater emphasis on community reinvestment.[97] These new requirements included mandatory employee training, verification that processes were implemented and followed, and a demonstration that lending outcomes reflect documented practices.[98]

The legislative and regulatory changes of 1989 significantly altered how banks experience CRA oversight. After these changes, the average duration of the CRA exam went from seven to thirty hours.[99] Further, a greater proportion of low grades were

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[91] Garrison Keillor, *Prairie Home Companion*, Minnesota Public Radio, 1974-2016

[92] Pub. L. No. 101-73, § 1212, 103 Stat. 183, 526-27 (1989). For more on FIRREA's legislative development, see Peter Conti-Brown & Brian Feinstein, *The Contingent Origins of Financial Legislation*, 99 WASH. U. L. REV. 145 (2021).

[93] 12 U.S.C. § 2906(b)(2). This disclosure requirement went into effect in mid-1990.

[94] This secrecy is called "confidential supervisory information," defined by regulation in 12 C.F.R. § 261.2(b)(1).

[95] 12 U.S.C. § 2906(b)(2).

[96] *See* Fishbein, *supra* note 88.

[97] Statement of the Federal Financial Supervisory Agencies Regarding the Community Reinvestment Act, 54 Fed. Reg. 13,742 (April 5, 1989).

[98] Id.

[99] Fishbein, *supra* note 88 at 303 (comparing average durations in 1989 and 1991).

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awarded (at least initially). In 1991, 10.4 percent of banks received one of the two less-than-satisfactory scores, a nearly five-fold increase over the grade distribution prior to FIRREA.[100] Regulators appeared to be taking a more rigorous approach—at least for a time.

Even so, the issue of community reinvestment remained a major, controversial, and unfinished part of the policy debates of the early 1990s. During the 1992 presidential campaign—which coincided with significant rioting in low-to-moderate-income and majority-minority neighborhoods in Los Angeles following the acquittal of police officers caught on video violently beating an unarmed man—candidate Bill Clinton made community reinvestment a priority,[101] promising to "pass[] a more progressive [CRA] to prevent redlining and . . . require[e] financial institutions to invest in their communities."[102] Six months into his presidency, Clinton instructed bank regulators to revamp the CRA to make sure that the banking needs of these communities were met more concretely.[103]

The banking agencies responded with a major regulatory overhaul in 1995.[104] That effort built on the 1989 changes to shift away from documenting CRA practices to actually showing results.[105] Instead of demonstrating that their procedures are adequate, without reference to lending outcomes, banks would now have to show that their actual lending activities across a variety of business lines are relevant to community reinvestment.[106]

Similarly, in 1994 Congress passed the Riegle-Neal Interstate Banking and Branching Efficiency Act to end the centuries-long prohibition on interstate banking and branching at the federal level.[107] The Act requires banks seeking to expand across state lines to seek approval of the relevant federal banking regulator. That approval, in

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[100] Figure calculated by authors from data available at Federal Financial Institutions Examination Council, Interagency CRA Rating Search, https://www.ffiec.gov/craratings/default.aspx. This calculation is consistent Allen Fishbein's assertion that 11 percent of banks received the lowest scores in the immediate aftermath of the 1989 law. *See* Fishbein *supra* note 88 at 302.

[101] David Lauter, *Clinton Gives Details of His Urban Aid Plan*, LA TIMES, September 17, 1992.

[102] Bill Clinton and Al Gore, Putting People First 12 (1992).

[103] A. Brooke Overby, *The Community Reinvestment Act Reconsidered*, 143 UNIV. PA. L. REV. 1431, 1432 (1995)

[104] 12 C.F.R. § 25.42 (1995).

[105] *See* Fishbein, *supra* note 88.

[106] 60 Fed. Reg. 22,157 (1995) (describing the multiyear process, beginning in 1993, of building a "more performance-based evaluation system").

[107] 12 U.S.C. § 1811.

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turn, requires the agency to consider "the ratings received by the out-of-State bank under the Community Reinvestment Act."[108]

The final legislative change to the CRA occurred in 1999. As the economy boomed in the 1990s, the zeitgeist took a deregulatory turn. Most notably, Congress in 1999 passed the Gramm-Leach-Bliley Act.[109] That law eliminated key parts of the New Deal financial legislative landscape by permitting banks to expand into lines of business—securities and insurance, primarily—that had previously been forbidden.[110] Remarkably, given Gramm-Leach-Bliley's deregulatory emphasis, the law also buttressed the CRA; it mandated that, in order for a bank to enter these new business lines, it must receive a score of *outstanding* or *satisfactory* on the CRA.[111]

Gramm-Leach-Bliley was Congress's last word on the CRA. Regulators, however, soon adopted a deregulatory posture. In 2005, banking regulators promulgated new rules that largely moved away from the idea that the CRA should be more onerous, the motivating ethos of the 1989-1995 changes, and toward the idea of providing regulatory relief to smaller banks and to expanding the definition of "community" away from the urban focus of the 1970s-1990s, and toward more lending priorities in rural areas.[112]

From 2005 to the present, the CRA regulatory regime has, in substantial part, essentially been frozen in amber. This period saw the rise of subprime mortgages and other complex financial products that often are concentrated in lower-income and majority-minority communities, a historic housing boom and bust, the widespread adoption of online banking and creation of mobile banking that seem poised to make the CRA's notion of a geographic assessment area obsolete, the rise of innovative (and sometimes predatory) fintech firms, and renewed attention to equity and racial justice around the Black Lives Matter movement. Yet the CRA's status quo endures.[113]

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[108] *Id.* at § 1835a(c)(2)(D)

[109] Gramm-Leach-Bliley Financial Services Modernization Act of 1999, Pub. L. 106-102, 113 Stat. 1338 (1999).

[110] For an overview of the politics behind the passage of GLB, see Conti-Brown & Feinstein, *supra* note 92, at 190-198.

[111] 12 U.S.C. § 2903(c).

[112] 12 C.F.R. § 25.42 (2005). The process that yielding these rules began as part of a 1995 regulatory redesign, when regulators committed to review the consequences of FIRREA's new approach to enforcement. 60 Fed. Reg. 22,161 (1995).

[113] Fierce debates about the CRA occurred during this period, albeit with no effect on the extant legal framework. For instance, he question of the CRA's contribution (or not) to the Global Financial Crisis was hotly debated. *Compare* CHARLES CALOMIRIS & STEPHEN HABER, FRAGILE BY DESIGN: THE POLITICAL ORIGINS OF BANKING CRISES AND SCARCE CREDIT (2014) *with* Neil Bhutta & Daniel Ringo, *Assessing the Community Reinvestment Act's Role in the Financial Crisis*, FED NOTES, BOARD OF

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That status quo may soon change. In May 2022, the three federal banking agencies issued a notice of proposed rulemaking. If finalized, their proposal would be the most ambitious overhaul of the CRA since at least 2005 and arguably 1995.[114] Importantly, even if the proposed rulemaking is implemented, the basic architecture of the regulatory regime will remain intact. The CRA will continue to place four groups in conversation: (1) banks must invest in (2) underserved communities and be evaluated by (3) bank supervisors in ways that generate information for (4) community activists, bank customers, and other outside parties.

C. Challenges

One explanation for the lack of CRA reform is simple: a lack of consensus regarding what, if anything, needs fixing.[115] The empirical literature on the CRA's impact is as vast as it is uncertain. The ultimate failure of the law to meaningfully address inequities in access to credit is readily apparent in the persistence of banking deserts, underinvestment in lower-income and minority communities, and the racial wealth gap.[116] Drill down, however, and specific policy interventions are hotly contested.

Nonetheless, we can identify three basic features of the regulatory architecture, but not its legislative structure, that stymie the CRA's success. *First*, the fragmented nature of the federal financial regulatory system, and the nature of its financing, invite strategic behavior from both regulated entities and the regulators themselves. The United States, uniquely in the world, has a mélange of chartering and quasi-chartering

GOVERNORS OF THE FEDERAL RESERVE SYSTEM, May 26, 2015. In addition, during the end of the Trump Administration in 2020, Acting Comptroller of the Currency Brian Brooks finalized a rule by the OCC—without the support of the other banking regulators—to "modernize" the CRA by giving banks much more flexibility in determining their CRA obligations with a wider variety of banking activities. 85 Fed. Reg. 34,734 (2020). After Joseph Biden's inauguration in 2021 and the appointment as Acting Comptroller of the Currency Michael Hsu, the rule was rescinded. 86 Fed. Reg. 71,328 (2021).

[114] *See* 12 C.F.R. Part 25. We review this notice of proposed rulemaking in Part III.XX, *infra*.

[115] *See, e.g.*, *supra* note 8

[116] *See* Rachel E. Dwyer, *Credit, Debt, and Inequality*, 44 ANN. REV. SOC. 237 (2018); BARADARAN, THE COLOR OF MONEy, *supra* note __; BARADARAN, HOW THE OTHER HALF BANKS, *supra* note __.

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authorities at both the state and federal level.[117] These chartering authorities are funded through fees assessed on the regulated entities.

The existence of multiple regulators encourages "charter hopping" and other forms of regulatory arbitrage, in which a financial-services firm determines which regulator has the most permissive posture and then alters its legal form—e.g., national bank, state-chartered bank, credit union, etc.—to fall under the umbrella of that regulator. Further, that regulators tend to be funded in significant part by fees from regulated financial institutions provides an incentive to agencies to adopt a more bank-friendly posture than other agencies, as regulated financial institutions shop for the most advantageous regulator.[118] When sellers compete for buyers in traditional markets, the result is lower prices and better products. When regulators compete for regulated entities, the result is more permissive regulation—a classic "race to the bottom."[119] In addition to this phenomenon, old-fashioned regulatory arbitrage is also present in the financial sector, wherein institutions like fintechs and credit unions—which are not subject to *any* kind of CRA regulation—organize themselves to engage in identical economic behavior but subject to very different (and much cheaper) regulatory requirements, including an ability to expand without meeting community-reinvestment requirements.[120]

Second, that CRA evaluations are based on banks' self-defined geographic footprint rather than the locations of their loans limits regulators' ability to assess the extent to which banks serve the needs of the communities in which they actually do business.[121] The CRA does not define the "community" in "community reinvestment," leaving to regulators to provide clarity on what area banks are meant to serve. The definition in the implementing regulation defers to the banks to determine their "assessment area," a definition that regulators do not interrogate.[122] The assessment area is linked to geography: it must be "one or more . . . metropolitan divisions . . . or

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[117] *See* Government Accountability Office, Report to Congressional Requesters, *Financial Regulation: Complex and Fragmented Structure Could Be Streamlined to Improve Effectiveness*, February 2016, https://www.gao.gov/products/gao-16-175.

[118] *See* David T. Zaring, *Modernizing the Bank Charter,* 61 WM. & MARY L. REV. (2020)

[119] *See* Kenneth E. Scott, *The Dual Banking System: A Model of Competition in Regulation*, 30 STAN. L. REV. 1, 12 (1977) (classic description of this competitive dynamic).

[120] *See* Victor Fleischer, *Regulatory Arbitrage*, 89 TEX. L. REV. 227 (2010)

[121] *See* 12 U.S.C. § 2901(a)(1) (stating Congress's finding, in enacting the CRA, that "regulated financial institutions are required by law to demonstrate that their deposit facilities serve the convenience and needs of the communities in which they are chartered to do business").

[122] 12 C.F.R. § 228.419(a)

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one or more contiguous political subdivisions, such as counties, cities, or towns, in which the bank has its main office, branch, or deposit-taking ATMs."[123]

This regulatory definition invites strategic behavior by regulated entities that are already subject to CRA regulations. Consider a bank that concentrates its ATM footprint in wealthier areas and avoids lower-income ones. In effect, that bank can gerrymander itself into a higher-income assessment area and, consequently, less onerous CRA examinations under certain circumstances.

The rise of online and mobile banking exacerbates this form of regulatory arbitrage. Recall that a bank's CRA assessment area matches that bank's *physical* footprint. Therefore, a bank that lends nationwide but maintains brick-and-mortar locations in limited areas would be evaluated only on loans to low-to-moderate-income borrowers within those areas. The invitation for strategic behavior is obvious: banks can concentrate their CRA-qualified lending within their (smaller) assessment area and ignore these communities within the larger area in which they originate loans via an online portal. Empirical research indicates that many banks behave in a manner consistent with this strategy: originate many more loans to low-to-moderate income borrowers within their CRA assessment areas than outside of these areas.[124]

Strategies of this type are more than another instance of regulatory arbitrage. Banks' ability to choose their geographic footprint in a way that reduces their CRA obligations is a major limitation to the prevailing model of community reinvestment.[125]

Third, a growing proportion of lenders lies outside of the CRA's regulatory perimeter. Credit unions and nondepository institutions, including non-bank mortgage

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[123] *Id.* § 228.41(b)

[124] *See Bank Lending Outside CRA Assessment Areas*, Housing Finance Policy Center, Urban Institute, Jan. 2022, https://naahl.org/wp-content/uploads/2022/01/Urban-CRA_Project-CRA-Assessment-Areas-v12.pdf; Eric Belsky, Michael Schill, and Anthony Yezer, *The Effect of the Community Reinvestment Act on Bank and Thrift Home Purchase Mortgage Lending*, Joint Center for Housing Studies, Harvard University, Aug. 2001, https://www.jchs.harvard.edu/sites/default/files/media/imp/belschillyezer_cra01-1.pdf.

[125] This form of arbitrage—honoring the law but choosing the most advantageous economic climate for its obedience—is not unusual and is common in the tax context. Fleischer, *supra* note __ at ___. A recent congressional experiment with Opportunity Zones, or areas of lighter tax and regulatory burdens meant to encourage investment in underserved areas, has shown similar results. See Brett Theodos, Jorge Gonzalez-Hermoso, and Brady Meixell, *The Opportunity Zone Incentive Isn't Living Up To Its Equitable Development Goals*, Urban Institute, June 17, 2020, https://www.urban.org/urban-wire/opportunity-zone-incentive-isnt-living-its-equitable-development-goals-here-are-four-ways-improve-it. Opportunity Zones are an adjacent policy area to the Community Reinvestment Act, since both are intended to bring private market financial activity into underserved areas.

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companies, are exempt from the CRA. Those carve-outs may have seemed sensible when the CRA was enacted in 1977, when banks dominated lending markets,[126] credit unions were small-scale, and the notion of shopping for a loan on one's computer or phone was the stuff of science fiction. Today, however, the two largest mortgage lenders, Quicken Loans and United Shore, are non-bank mortgage companies;[127] some credit unions rival major banks in size;[128] conventional banks have sizable online banking operations;[129] and the growth of online-only lenders, peer-to-peer lending, crowdfunding, and other fintech innovation continues apace.[130]

That an increasing number of lenders stands outside of the CRA's ambit constitutes an obvious threat to achieving the law's objectives. Unsurprisingly, lenders that are not subject to the CRA do not prioritize lending to low-to-moderate income borrowers to the same extent that CRA-covered banks do.[131] That CRA-covered banks prioritize lending to these borrowers to a greater degree than other lenders both indicates that the CRA *can* be effective—viz. empirical studies show that lenders change their behavior in response its CRA coverage[132]—and also highlights a shortcoming: that a growing number of lenders are not subject to the statute.

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[126] *See* Marshall Lux and Robert Greene, *What's Behind the Non-Bank Mortgage Boom?*, Mossavar-Rahmani Center for Business & Government, Harvard Kennedy School, Working Paper No. 42, https://www.hks.harvard.edu/centers/mrcbg/publications/awp/awp42.

[127] *See* Jason Richardson and Jad Edlebi, *Preliminary Analysis of 2019 HMDA Mortgage Lending Data*, National Community Reinvestment Coalition, June 30, 2020, https://www.ncrc.org/preliminary-analysis-of-2019-hdma-mortgage-lending-data/.

[128] Josh Silver, *Expanding CRA to Non-Bank Lenders and Insurance Companies*, National Community Reinvestment Coalition, Aug. 27, 2020, https://ncrc.org/expanding-cra-to-non-bank-lenders-and-insurance-companies/. The largest, Navy Federal Credit Union, is one of the top-25 lenders nationwide. Id.

[129] *See* Lei Ding and Carolina K. Reid, *The Community Reinvestment Act (CRA) and Bank Branching Patterns*, 30 HOUSING POL'Y DEBATE 27, 42 (2020).

[130] *See* William Magnuson, *Regulating Fintech*, 71 VANDERBILT L. REV. 1167, 1173-1187 (2019).

[131] *See* Lei Ding and Leonard Nakamura, *"Don't Know What You Got Till It's Gone"—The Community Reinvestment Act in a Changing Financial Landscape*, 43 J. REAL ESTATE RES. 96 (2021) (finding that, following the withdrawal of CRA-designation from an area, CRA-covered banks reduce their supply of credit to that area, and non-CRA-covered lenders only *partially* offset this loss); National Community Reinvestment Coalition, *Credit Unions: True to their Mission?*, 2009, at 4, https://ncrc.org/wp-content/uploads/2009/09/creditunionreport090309.pdf (reporting that credit unions do not serve low-to-moderate income borrowers nearly as well as do banks that are subject to the CRA); Robert Avery, Paul Calem, & Glenn Canner, *The Effects of the Community Reinvestment Act on Local Communities*, FED. RES. SYS., DIV. OF RES. AND STAT. 27 (2003), https://www.federalreserve.gov/communityaffairs/national/ca_conf_suscommdev/pdf/cannerglen.pdf.

[132] See supra note.

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D. Growing Inequality and the CRA

The preceding discussion of the CRA's purpose, history, and limitations is valuable because the CRA is, simply put, the most important federal financial legislation focused on reducing inequality in America. As noted above, some financial laws emphasize nondiscrimination or information-provision without an affirmative obligation to elevate under-resourced or under-served populations.[133] Other financial statutes include on their periphery measures aimed at these populations.[134] No other law, however, has as its central aim to affirmatively redress inequalities in the real economy by directing the activites of the financial sector. That policy focus is at the core of the CRA: to redistribute wealth and economic growth by channeling intermediated finance from areas in which private actors will readily deploy it towards areas in which it has been lacking, in some cases for generations.

The CRA's objective to redress inequality remains as important today as it was in 1977. Rising inequality is among the most critical policy challenges in the United States. According to a recent report from the Council on Foreign Relations, "income and wealth inequality in the United States is substantially higher than in almost any other developed nation."[135] Because of the racially stratified nature of U.S. society, African Americans and other racial minorities bear the brunt of these inequities, which race-based discrimination throughout the system serves to amplify. As race and finance scholar Mehrsa Baradaran contends, "though hard to detect, [the racial wealth gap] is nonetheless *the* defining feature of America's racial divide because it is intimately linked to so many other problems."[136] Further, these problems are growing; overall wealth inequality and the racial-wealth gap have increased markedly in the past few decades.[137]

Naturally, one cannot place the blame for rising wealth inequality and a growing racial wealth gap—complex, multi-casual phenomena—exclusively on the CRA's doorstep. Indeed, studies show that the law contributes to modest increases

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[133] *See, e.g.,* 15 U.S.C. § 1691 et seq. (Equal Credit Opportunity Act of 1974); 12 U.S.C. § 2801 et seq. (Home Mortgage Disclosure Act of 1975).

[134] Title X of the Dodd-Frank Act, for example. Pub. L. 111-203, (Dodd-Frank Wall Street Reform and Consumer Financial Protection Act of 2010).

[135] Anshu Siripurapu, *The US Inequality Debate*, Council on Foreign Relations, April 20, 2022, available at https://www.cfr.org/backgrounder/us-inequality-debate#:~:text=In%202021%2C%20the%20top%2010,percent%20of%20wealth%20in%202021.

[136] BARADARAN, *supra* note ___ at 1.

[137] Aladangady and Forde, *supra* note __.

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bank activities in underserved areas.[138] Notably, however, substantial inequalities also persist in access to credit—the narrower, seemingly more tractable problem that the CRA was designed specifically to address. For instance, millions of Americans live in banking deserts, without convenient access to a retail bank branch.[139] In the mid-2010s, a majority of African Americans either lacked a bank account or borrowed money from a payday lender or similar "alternative" firm—typically at a substantially higher interest rate[140]—within the past year.[141] Black and Hispanic checking-account owners pay two-to-three times the average account fees as white customers.[142]

Inequalities in residential-mortgage and business lending also are pronounced. The stakes here are high; most homes are purchased with a mortgage and most businesses utilize loans to finance growth.[143] Concerning home loans, African Americans face discrimination in loan approval rates and loan terms, and majority-Black neighborhoods are disproportionately targeted by predatory lenders.[144] Black entrepreneurs—who are substantially underrepresented as business owners—face similar challenges accessing credit on the same terms as other businesspeople.[145] Controlling for firm characteristics and other relevant factors, Black-owned startups are substantially more likely to be denied credit, receive lower business credit scores and, when they are offered loans, are presented with less favorable loan terms than other startups.[146] They also are less likely to apply for business loans than similarly

[138] *See supra* note __.

[139] By the conventional definition, 3.7 million Americans live in banking deserts, or census tracts for which there is not a retail bank branch within 10 miles of the center of the tract. Drew Dahl and Michelle Franke, *"Banking Deserts" Become a Concern as Branches Dry Up*, THE REGIONAL ECONOMIST, https://www.stlouisfed.org/-/media/project/frbstl/stlouisfed/Publications/Regional-Economist/2017/Second_quarter_2017/bank_deserts.pdf. That 10-mile definition seems grossly overinclusive to us, particularly for urban and suburban residents lacking a car or adequate public-transportation system. Indeed, even with a car, a 10-mile one-way drive through city traffic—essentially, the entire east-west length of Philadelphia—involves a substantial investment of time.

[140] Kristen Broady, Mac McComas, and Amine Ouazad, *An Analysis of Financial Institutions in Black-majority Communities*, BROOKINGS, Nov. 2, 2021.

[141] Burhouse, et al., *supra* note __.

[142] Broady, et al., *supra* note __.

[143] Id.

[144] Id.

[145] Id.

[146] Loren Henderson, Cedric Herring, Hayward Horton, and Melvin Thomas, *Credit Where Credit is Due?: Race, Gender, and Discrimination in the Credit Scores of Business Startups*, 42 REV. BLACK POL. ECON. 459 (2015); David Blanchflower, Phillip Levine, and David Zimmerman, *Discrimination in the Small-Business Credit Market*, 85 REV. ECON. & STAT. 930 (2003).

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situated white business owners in the first instance.[147] Unsurprisingly, business activity lags in majority-Black neighborhoods.[148]

In enacting the CRA, Congress aimed to address these very problems.[149] The legislation was designed to put more working capital into the hands of lower-income and minority households and businesses, so that they can use finance to achieve greater prosperity. Despite some evidence of limited success,[150] the failures of informational disclosures in the examinations themselves severely limit CRA's ability to perform its basic function to reduce this inequality. As a result, income and wealth inequality, by virtually every conceivable measure, continues to worsen.

CRA examinations, if implemented effectively, could make decisive contributions to eliminating banking deserts, expanding access to credit, and reducing the racial wealth gap. These examinations could create incentives, positive and negative, for banks to engage with underserved communities for safe-and-sound banking profit. They also could provide useful information to regulators assessing banks' merger or expansion applications to determine the extent to which these banks meet their community reinvestment obligations. Finally, CRA examinations could create an information-sharing system whereby all interested parties—banks and customers, activists and regulators—are able to assess the success of these efforts.

The practice of the CRA does not match this potential. The problem is not the statute's structure. The problem is its implementation. The next Part describes how bank examiners' assessments impede the statute's ability to redress inequalities.

II. GRADE INFLATION

As Senator Proxmire noted in 1989, the CRA suffers from a Lake Wobegone problem, where CRA examiners concluded that nearly all U.S. lenders are "satisfactory" or "outstanding."[151] What social scientists term the *Lake Wobegon effect*,

[147] Robert Fairlie, Alicia Robb, and David Robinson, *Black and White: Access to Capital among Minority-owned Startups*, NBER Working Paper 29154, Nov. 2020. That Black businesspeople are less likely to apply for business loans than are similarly situated white businesspeople is unsurprising in light of these expected disparate outcomes.

[148] Broady, et al., *supra* note __.

[149] *See* Part I.A, *supra*.

[150] *See, e.g.*, Ding and Nakamura, *supra* note __; National Community Reinvestment Coalition, *supra* note __; Avery, Calem, & Canner, *supra* note __.

[151] *See* Discrimination in Home Mortgage Lending: Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs, *supra* note __.

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or the tendency to overestimate individuals' capacities relative to others, can have pernicious consequences.[152] For instance, overconfident surgeons may conduct procedures that are net detriments based on their expected risk and reward.[153] Or assessment tests inaccurately reporting that most students are above the median could lull students and educators into unwarranted complacency.[154]

Senator Proxmire's concerns regarding a potential Lake Wobegon effect with CRA examinations were well-founded. Unfortunately, the 1989 changes to the CRA that he championed did not resolve the issue. Since 1990, the overwhelming majority of financial institutions are rated *outstanding* or *satisfactory*. Indeed, since that year only 3.6 percent of financial institutions have received one of the two lowest ratings on the CRA's four-point scale, the point at which there are real regulatory consequences to the banks.[155] Further, that figure is declining; it approaches zero in recent years.

This Part documents the CRA's Lake Wobegon problem, especially as it has progressed since the 1989 reforms, and compares CRA examination scores to other common ratings of financial institutions that do not suffer from this pathology.[156]

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[152] *See, e.g.*, Rachel M. Hayes and Scott Schaefer, *CEO Pay and the Lake Wobegon Effect*, 94 J. FIN. ECON. 280 (2009); Nan L. Maxwell and Jane S. Lopus, *The Lake Wobegon Effect in Student Self-Reported Data*, 84 AM. ECON. REV. 201 (1994).

[153] *See* Nicholas L. Berlin, Ted A. Skolarus, Eve Kerr, and Lesly A. Dossett, *Too Much Surgery: Overcoming Barriers to De-Implementation of Low-Value Surgery*, 271 ANN. SURG. 1020 (2021).

[154] *See* Christopher Connell, *"Lake Wobegon" Tests: All Students Above Average*, AP, Feb. 10, 1988, https://apnews.com/article/a76acef384add387e9fc66ffcb98e560 (describing a study finding that all 50 states reported that its students were above the national average).

[155] *See* Congressional Research Service, *supra* note __.

[156] There are two explanations for these results. The first is that it is a vanishingly rare phenomenon for banks to need improvement in their CRA obligations; there are virtually no banks that are in substantial noncompliance with respect to these obligations. In that view, the problem of community reinvestment has been solved. That rosy picture of financial institutions' CRA performance requires a willful disregard of the persistence of "banking deserts" lacking mainstream financial services and chronic underinvestment in low-income and majority-minority areas.

The alternative explanation is that the exam results themselves do not reflect reality, that they obscure more than they reveal. For the reasons discussed below, we find the second explanation more plausible. By labeling the vast majority of banks above average despite these persistent issues, CRA examiners deprives regulators and the public of useful information concerning differences among banks in lending to underserved communities.

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A. A Skewed Distribution

We obtain data on CRA ratings from an examinations database maintained by the Federal Financial Institutions Examination Council (FFIEC).[157] FFIEC collects data on CRA examinations administered by the OCC, FDIC, and Office of Thrift Supervision (OTS) – the former regulator and supervisor of thrifts and savings banks – beginning in 1990, and for the Federal Reserve starting in 1995. The dataset runs through the present for the OCC, FDIC, and Federal Reserve; OTS evaluations cease with that agency's dissolution in 2011, after which the OCC has supervised national thrifts.[158] Among the 78,642 included examinations, FDIC conducts a majority (62 percent), followed by OCC (18 percent), OTS (11 percent), and the Federal Reserve (9 percent). For each of the over seventy-eight thousand included examinations, the dataset notes the exam score, date, the regulator that conducted the exam, the name of the regulated financial institution, and several other fields.

Figure 1 displays the distribution of scores assigned by the four regulators during the 1990-2021 period.

[157] *See* FFIEC, *supra* note __.
[158] 12 U.S.C. § 5412.

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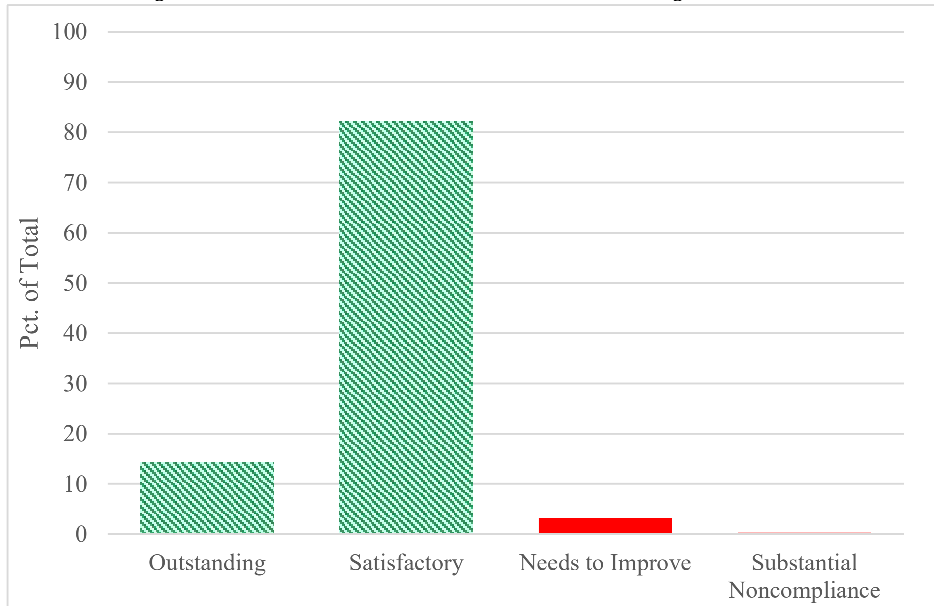
Figure 1: Distribution of CRA Scores, All Agencies 1990-2021[159]



As the figure shows, the vast majority—82 percent—of financial institutions receive a CRA rating of satisfactory (denoted as 2). Another 14 percent are rated outstanding (1). At the lower end, 3 percent need to improve (3). Incredibly, zero percent, when rounded, are labeled as being in substantial noncompliance (4).[160]

Further, the distribution of scores awarded by each of the four agencies adheres essentially to this same distribution. Table 1 summarizes this information, presenting the proportion of *outstanding*, *satisfactory*, *needs to improve*, and s*ubstantial noncompliance* ratings awarded by each agency. The table also displays the total proportion of low scores awarded, meaning *needs to improve* and s*ubstantial noncompliance* ratings, both of which convey negative sentiment and a call for the financial institution to boost its community-reinvestment lending.

[159] Key to scores: 1 = outstanding, 2 = satisfactory, 3 = needs to improve, 4 = substantial noncompliance. Figure generated from 14,173 CRA evaluations conducted by the OCC between 1990 and 2021; 6,741 conducted by the Federal Reserve 1995-2021; 48,825 conducted by the FDIC 1990-2021; and 8,903 conducted by OTS 1990-2011.

[160] This distribution resembles a log-normal distribution or, better yet, a Weibull distribution with a relatively low value for the scale parameter η.

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Table 1: Distribution of Scores by Agency[161]

	All	OCC	FRB	FDIC	OTS
Outstanding (1)	14%	17%	16%	13%	18%
Satisfactory (2)	82%	81%	83%	84%	74%
Needs to Improve (3)	3%	2%	1%	3%	7%
Substantial Noncompliance (4)	0%	0%	0%	0%	1%
Low Score (3 or 4)	*3.55%*	*1.78%*	*1.42%*	*3.52%*	*8.09%*

All four agencies demonstrate an extreme reluctance to label financial institutions in substantial noncompliance with the CRA; 1 percent of OTS-examined institutions receive this designation, and even fewer OCC, Federal Reserve, and FDIC-examined banks receive it. Examiners also rarely reach the conclusion that a financial institution needs to improve, a more modest, less accusatory label, but one that carries with it regulatory and legislative consequences. The Federal Reserve determines that only 1 percent of the financial institutions that it examines needs to improve its CRA lending, with the OCC and FDIC being marginally more critical of their regulated institutions. OTS is an outlier to some extent. Although no one would mistake its 1 percent of *substantial noncompliance* scores and 7 percent of *needs to improve* scores as draconian, OTS demonstrated a relatively more stringent posture than its fellow regulators.

For another perspective, Table 2 reports descriptive statistics concerning the overall distribution of scores, alongside the distribution for each of the four agencies.

[161] Some columns do not sum to 100% due to rounding. Table includes OCC and FDIC scores for 1990-1995, Federal Reserve scores for 1995-2021, and OTS scores for 1990-2011.

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Table 2: Summary Statistics[162]

	All	OCC	FRB	FDIC	OTS
Median	2	2	2	2	2
Mean	1.90	1.85	1.86	1.91	1.91
Std. Deviation	0.42	0.41	0.40	0.41	0.52
Observations	78,642	14,173	6,741	48,825	8,903
Years	1990-2021	1990-2021	1995-2021	1990-2021	1990-2011

As Table 2 reports, each agency's median score 2. With the mean (1.90) slightly lower than this median, CRA scores assigned by each agency tend to be skewed to the left.[163] CRA scores tend to be tightly clustered around this mean. The standard deviation across all four agencies is 0.42, with that figure ranging from 0.40 for the Federal Reserve to 0.52 for OTS—relatively small numbers on a four-point scale.

B. Grade Inflation

CRA examiners' propensity to convey negative assessments has declined markedly over the past several decades. Figure 2 shows the tendency of the financial regulatory agencies to assign scores of *needs to improve* and *substantial noncompliance*. To generate this figure, each examination report is coded as a 1 if the financial institution received one of these low scores, and coded as zero otherwise. The trend line—technically, a locally-weighted regression line—displays the proportion of institutions receiving these low scores over time. The shaded regions on either side of the line show standard errors.

[162] The FFIEC codes Outstanding as 1, Satisfactory as 2, Needs to Improve as 3, and Substantial Noncompliance as 4.

[163] Skewness for the four agencies overall is -0.40, and ranges from -1.00 for OCC 0.17 for OTS. The distributions also exhibit excess kurtosis: 6.40 overall, with a range from 4.77 for OCC to 7.13 for FDIC, indicating that the distribution has longer tails—and thus is more tightly clustered around its mean—than the normal distribution.

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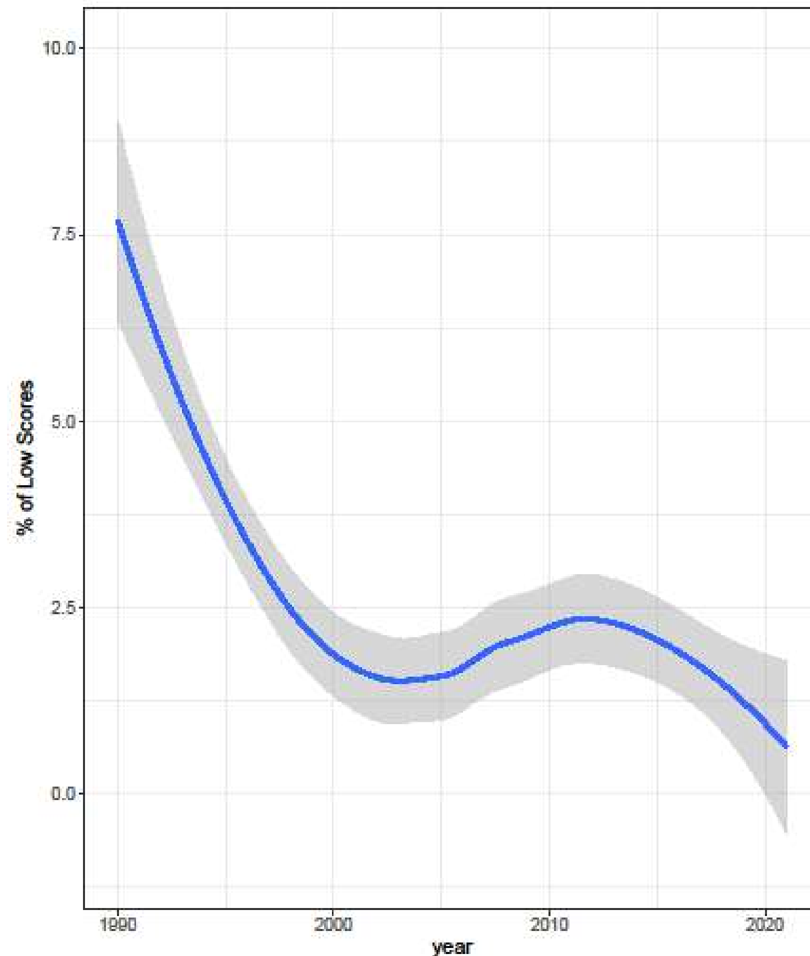
Figure 2: Trends in Proportion of Low Scores



The trend in Figure 2 is unmistakable. The proportion of negative CRA scores has declined markedly during the past several decades, from 7.6 percent during the mid-1990s to 0.5 percent in the first half of 2021.[164] While commentators praised the 1989 reforms for solving the Lake Wobegon problem that Senator Proxmire identified,[165] the problem has since metastasized. Further, this trend is apparent across all four agencies. Figure 3 breaks out the proportion of low scores by examiners in each of the banking agencies.

Figure 3: Trends in Proportion of Low Scores

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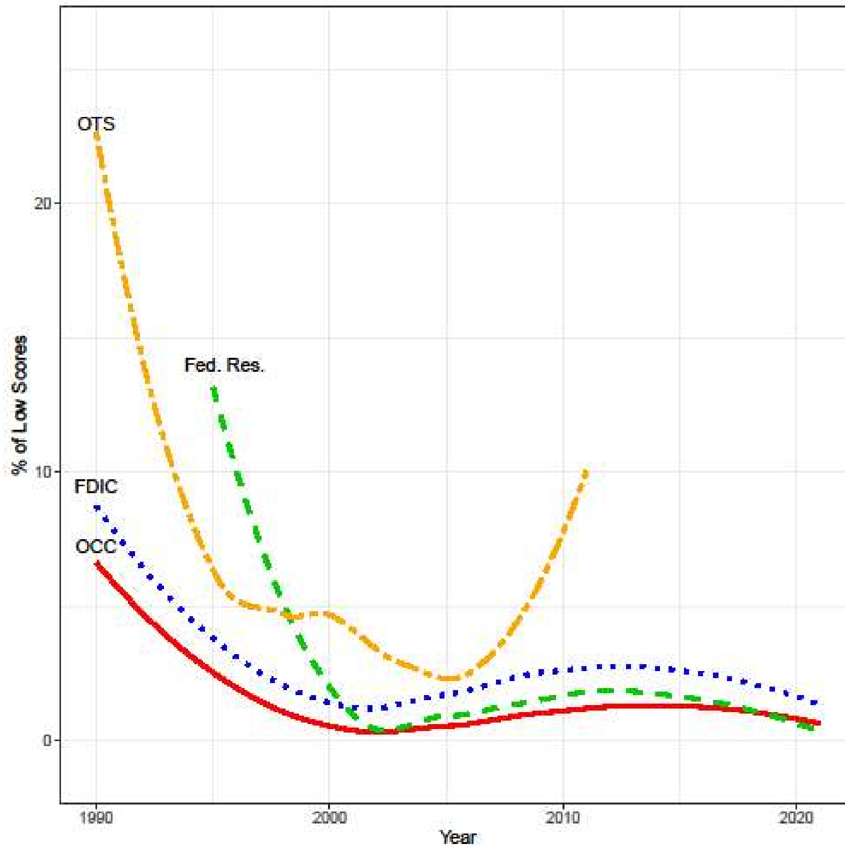

As the figure shows, all of the agencies exhibit a greater propensity to issue low scores in their first few years of reporting. This early assertive posture is most pronounced at the OTS. In 1990, *needs to improve* and *substantial noncompliance* scores comprised almost one-quarter of all CRA scores assigned by OTS examiners.[166] That agency's willingness to assign low scores did not last; the proportion of low scores that it awarded declined precipitously during the 1990s before rising again in the late 2000s—albeit not nearly to its early 1990s peak—until OTS's dissolution in 2011.

That OTS delivered an increasing proportion of low scores in the late 2000s, while other regulators did not, is intriguing. Conventional wisdom holds that OTS was a particularly lax regulator in these years.[167] Indeed, OTS weakened its CRA regime in

[166] For context, see Poor CRA Performance Prompts OTS To Deny Thrift Applications, 13 No. 5 BANKING POL'Y REP. 7 (1994).

[167] *See* Dain C. Donelson & David Zaring, *Requiem for a Regulator: The Office of Thrift Supervision's Performance during the Financial Crisis*, 89 N.C. L. REV. 1778, 1779-80 (2011). That conventional wisdom,

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the mid-2000s to a much greater extent than other regulators did.[168] One possible explanation for this rise is that, as the balance sheets of OTS-regulated thrifts became stressed in the years leading up to and during the financial crisis, these thrifts jettisoned their community-lending responsibilities in an effort to remain afloat. Another possibility is that, as criticism mounted against the OTS's alleged lax regulatory posture as a cause of the mortgage-finance-induced great recession, the agency adopted a more assertive approach in an (ultimately unsuccessful) effort to curry favor with lawmakers and avoid dissolution. These are merely conjectures, however; a definitive explanation for the mid-2000s rise in the proportion of low OTS-assigned scores remains elusive.

The other agencies also exhibited an early burst of critical assessments followed by a steep decline. Unlike the OTS, the proportion of *needs to improve* and *substantial noncompliance* scores assigned by the OCC, Federal Reserve, and FDIC remained low—sometimes only trivially higher than zero—for the remainder of the period.

C. Alternatives

Thus far, this Part has shown that bank examiners concentrate their assign CRA ratings of *satisfactory* and *outstanding* almost exclusively. Further, their propensity to assign these lower scores has substantially increased since the 1990s.

These features are highly unusual. Other assessments of banks—namely, credit ratings and Yelp consumer-satisfaction scores—display far greater variation and include a larger proportion of low scores. That these distributions are bell-shaped indicates that other important audiences—investors relying on credit ratings and

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however, has been subject to challenge, with no evidence that institutions that switched to an OTS charter during this period performed relatively worse than other institutions during the financial crisis and only marginal support for the contention that thrifts overall performed worth than other financial institutions during the crisis. *See id.* at 1809.

[168] In 2004, OTS raised the asset limit used to define "small thrifts" that could participate in streamlined, less comprehensive CRA examinations from $250 million to $1 billion. The other three financial regulators took the more modest step of creating a new "intermediate small bank" category for banks with between $250 million and $1 billion in assets. In 2005, OTS permitted large thrifts to opt out of CRA evaluations of the investment and other services that they provide to low and moderate-income communities and instead only be evaluated based on their lending to these communities. The other financial regulators did not follow suit. *See* Statement of Geoff Smith, Woodstock Institute, Hearing Before the Subcommittee on Oversight & Investigations, House Committee on Financial Services, May 25, 2006, https://www.govinfo.gov/content/pkg/CHRG-109hhrg31043/html/CHRG-109hhrg31043.htm.

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potential customers considering Yelp scores when deciding where to take their business—comprehend and value a wider distribution than CRA examinations offer. The remainder of this Part presents these credit ratings and consumer-satisfaction scores as alternative distributions.

i. Credit Ratings

Credit ratings are a well-established assessment of firms' balance sheets and risk.[169] Several credit-ratings agencies assess corporations based on their ability and commitment to meet their credit obligations.[170] During our 1990-2021 study period, one prominent agency, Standard & Poor's (S&P), issued 21,514 entity-level credit ratings for U.S. financial institutions.[171] S&P assigns entity ratings ranging from D to AAA. Ratings of BBB and above are considered investment-grade, whereas those below are speculative.[172]

Figure 4 displays the distribution of S&P entity-level scores. Investment-grade entities are shaded green with diagonal lines; entities with speculative ratings appear in solid red.

[169] *See* Andrea Miglionico, The Governance of Credit Rating Agencies: Regulatory Regimes and Liability Issues (2019).

[170] *See* S&P Global RatingsDirect, Ratings Definitions, Aug. 18, 2016, at 4, https://www.maalot.co.il/Publications/GMT20160823145849.pdf.

[171] Data obtained via S&P Global Market Intelligence, Capital IQ Entity Ratings. We included entity ratings for which the United States is listed in the country field and the North American Industry Classification System (NAICS) industry code corresponds to commercial banking (522110) or offices of bank holding companies (551111).

[172] S&P Global RatingsDirect, *supra* note 170 at 4. S&P considers institutions receiving a BB or below have challenged "capacity or willingness . . . to meet [their] financial obligations." Id.

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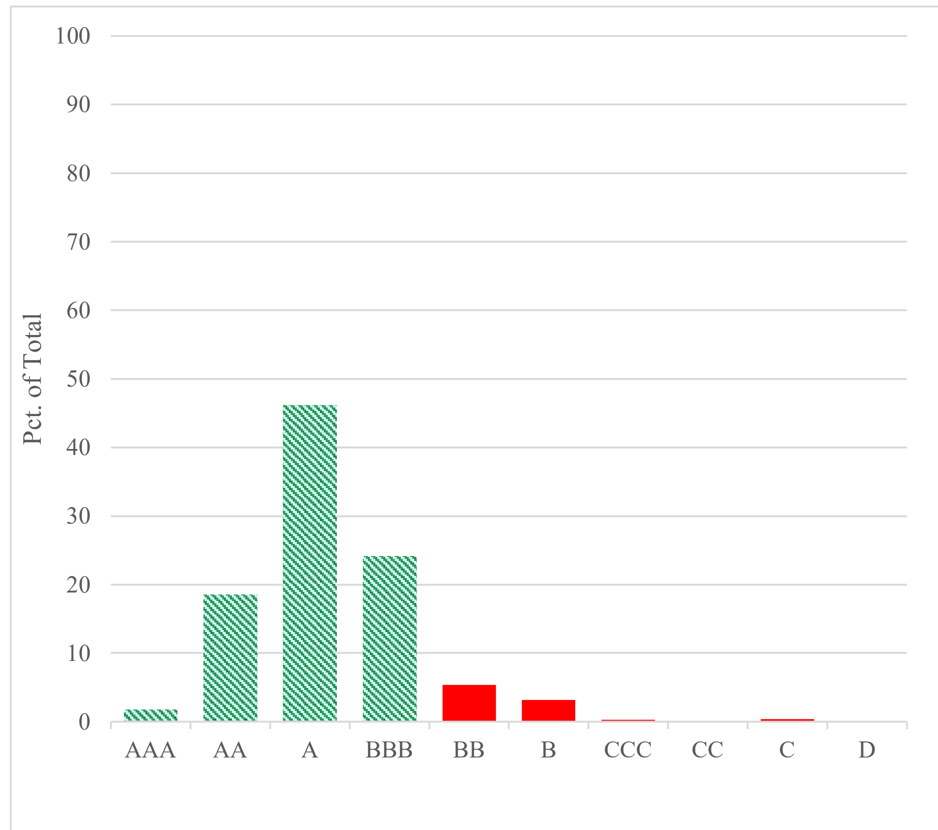
Figure 4: Distribution of S&P Entity Scores for Banks, 1990-2020[173]



The figure shows several marked differences between the distribution of financial institutions' CRA scores and their entity-level credit ratings. *First*, S&P

[173] Figure generated from 21,514 S&P entity reports for NAICS-classified commercial banks and offices of bank holding companies between 1990 and 2021. Key to scores: AAA = "extremely strong capacity to meet financial commitments"; AA = "very strong capacity to meet financial commitments"; A = "strong capacity to meet financial commitments, but somewhat susceptible to economic conditions and changes in circumstances"; BBB = "adequate capacity to meet financial commitments, but more subject to adverse economic conditions"; BB = "less vulnerable in the near-term but faces major ongoing uncertainties to adverse business, financial and economic conditions"; B = "more vulnerable to adverse business, financial and economic conditions but currently has the capacity to meet financial commitments"; CCC = "currently vulnerable and dependent on favorable business, financial and economic conditions to meet financial commitments"; CC = "highly vulnerable; default has not yet occurred, but is expected to be a virtual certainty"; C = "currently highly vulnerable to non-payment, and ultimate recovery is expected to be lower than that of higher rated obligations"; D = "payment default on a financial commitment or breach of an imputed promise; also used when a bankruptcy petition has been filed." AAA-BBB are investment grade; BB-

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exhibits a greater willingness to levy low or unfavorable scores than financial regulators and supervisors.[174] Recall that financial regulators offer CRA scores with a negative gloss—namely, an assessment of *needs to improve* or *substantial noncompliance*—only on 3.6 percent of CRA examinations. S&P, however, affixes its negative "speculative grade" label to 9.5 percent of financial institutions during the same time span

Second, credit ratings are not as tightly clustered as CRA scores. Eighty-two percent of financial institutions receive the median CRA assessment of "satisfactory." By contrast, only 47.2 percent of institutions receive the median "A" credit rating.

Third, S&P provides ten possible ratings, whereas the agencies administering the CRA offer only four. The S&P's scale therefore offers greater opportunity for differentiation and, thus, precision in its estimates.

That S&P deems so many financial institutions to be sub-investment grade is particularly noteworthy. Banks' credit postures are disciplined in three ways: by the market, via a vast regulatory apparatus aimed at preventing these kinds of outcomes, and through constant bank supervision that is unusual among regulated entities.[175] S&P's BB rating conveys that the firm faces "major ongoing uncertainties to adverse . . . conditions." In an important sense, prudential regulation and supervision exists to militate against such a conclusion. That 9.5 percent of financial institutions *still* receive a credit rating of BB or below despite the existence of a complex regulatory regime designed to ensure the safety and soundness of these firms is remarkable.[176]

More generally, Figure 4 also shows that S&P's customers, fixed-income investors, both understand and appreciate a distribution with some variation. S&P is

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D are speculative grade. S&P Global, Understanding Ratings, https://www.spglobal.com/ratings/en/about/understanding-ratings.

[174] The distribution of CRA scores exhibits a skew of -0.40, indicated that the distribution is shifted more towards scores of 1 ("Outstanding")—than 3s and 4s ("Needs to Improve" and "Substantial Noncompliance"). By contrast, the distribution of S&P entity ratings has a skew of 1.32, which indicates that this distribution has fatter tails on the side of the distribution in which the lower scores—BB and below—are located.

[175] CONTI-BROWN & VANATTA, *supra* note 83.

[176] On other hand, financial institutions are underrepresented in S&P's speculative-grade categories. Approximately 44.1 percent of all U.S.-based entities were rated at or below BB during the study period. Figure calculated by authors from S&P Global Market Intelligence, *supra* note __; *see also* Diane Vazza, Nick Kraemer, and Evan Gunter, *U.S. Corporate Debt Market: The State of Play in 2019*, S&P Global, May 17, 2019, https://www.spglobal.com/en/research-insights/articles/u-s-corporate-debt-market-the-state-of-play-in-2019#:~:text=The%20majority%20(72%25)%20of,U.S.%20corporate%20issuer%20credit%20ratings (reporting that 57 percent of U.S.-based companies that S&P rated in 2018 were speculative-grade).

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a for-profit enterprise operating in a competitive industry. That it is willing to place financial institutions along essentially a bell curve suggests not only that fixed-income investors can comprehend such a distribution, but also that the market values it. Indeed, that point is obvious: S&P ratings are valuable to investors in part because sufficient variation exists in their distribution. If, for instance, 82% of banks received the modal rating and another 14% received the second-most common one, the ratings presumably would be considerably less useful to investors.

ii. Customer Satisfaction Ratings

Banks' retail customers—and, indeed, any motivated person with an internet connection—also rate their experiences with those banks. Perhaps the best-known ratings aggregator is Yelp.com, a website containing 224 million crowdsourced reviews of consumer-facing businesses,[177] including bank branches and other financial services firms.[178] Yelp ratings range from 1 to 5 "stars." Unlike the objective, defined factors that CRA examiners and credit-ratings agencies utilize, Yelp ratings are based on any criteria that the reviewer deems important, ranging from the bank's ability to execute basic services and alleged fraudulent fees to the cleanliness of the branch and the placement of its parking lot.[179]

Utilizing a dataset containing 8.6 million Yelp reviews of 160,000 businesses,[180] we extract the 1-5 star ratings that Yelp users assigned to local bank branches and other financial-services firms.[181] Figure 5 shows the distribution of stars that Yelp reviewers assign to these financial institutions. For ease of interpretation, this

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[177] Cumulative number of reviews submitted to Yelp, STATISTA, Feb. 2022, https://www.statista.com/statistics/278032/cumulative-number-of-reviews-submitted-to-yelp/.

[178] *See* John Carroll, *The Complete Yelp Business Category List*, YELP BLOG, Jan. 31, 2018, https://blog.yelp.com/businesses/yelp_category_list/#section7.

[179] https://www.yelp.com/biz/suntrust-chestertown?osq=suntrust ("I had to cash a foreign check, which seemed to utterly puzzle [the employees] . . . If your bank people don't know what a Pound Sterling is, you're in trouble."); https://www.yelp.com/biz/bank-of-the-west-san-francisco-3 ("Bank of the West charged me a $35 overdraft fee caused by their system error. When I contacted them, Bank of the West tried to cover up their mistake by claiming the $35 fee is a service cancellation fee. . . . But I never clicked [the cancel service] button, and my online banking notification message clearly states that the $35 is an overdraft fee, not a cancellation fee."); https://www.yelp.com/biz/chase-bank-menlo-park-4 ("really nice bank clean easily accessible from parking lot").

[180] Yelp, Yelp Open Dataset, https://www.yelp.com/dataset.

[181] We identified these businesses based on Yelp's placement of the business in the "banks and credit unions," "financial services," or "mortgage lenders" category.

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distribution is placed on the same scale as the distributions of CRA scores Figure 1 and S&P entity ratings in Figure 4.

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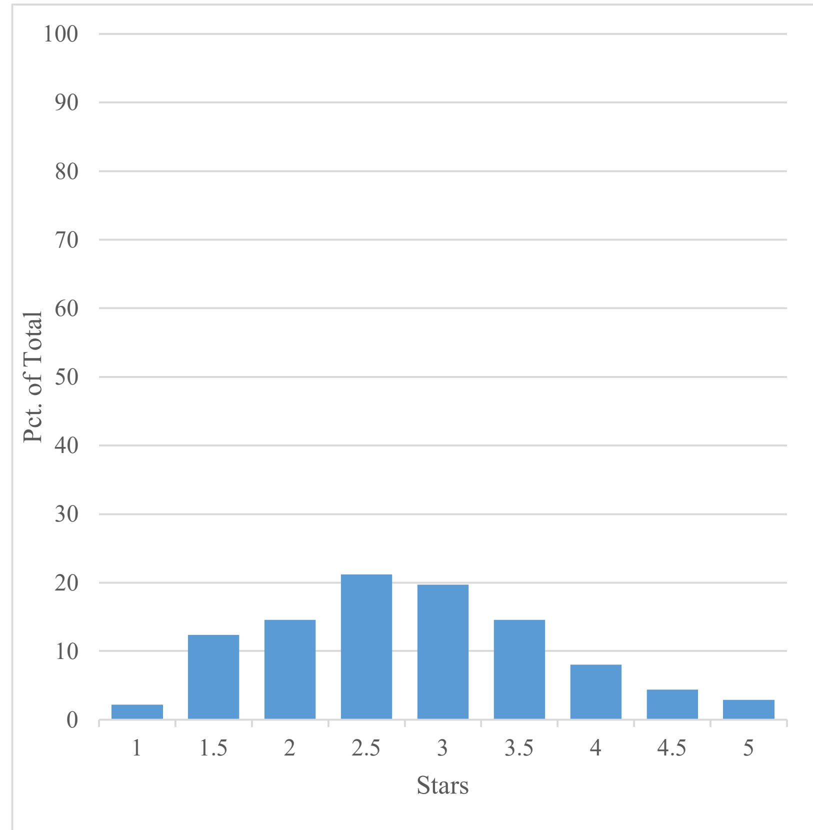
Figure 5: Distribution of Yelp Reviews of Financial Institutions



The greater variation in Yelp scores relative to CRA ratings is readily apparent. Yelp reviewers' scores approach a normal distribution,[182] with a low, broad peak and few outliers.[183] Financial institutions possess a mean Yelp score of 3.3 and median of 3, which is squarely at the center of Yelp's 5-point scale. The standard deviation of 1.2 signifies that over two-thirds of observations fall between 2.1 and 4.5. That is a remarkably broad range within a 1-5 scale. By comparison, recall that CRA scores, which are arrayed on a 4-point scale, have a standard deviation of only 0.4.[184]

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[182] Skewness, which is a measure of the extent to which the distribution departs from a symmetrical bell curve, is negligible: -0.03 for Yelp scores, compared to -0.40 for CRA scores and 1.32 for S&P entity ratings.

[183] Kurtosis, a measure of the extent to which a distribution has extreme values in its tails, is remarkably low: 1.86 for Yelp scores, compared to 6.40 for CRA scores, 7.51 for S&P entity ratings.

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[184] Yelp scores also exhibit much greater variation than some other well-known crowdsourced scores. Most notably, consumer-submitted product reviews on Amazon.com often conform to a J-shaped distribution: a large majority of reviews assigning the highest score to the product or service, some reviews assigning the lowest score, and very few reviews in-between. Verena Schoenmueller, Oded Netzer, and Florian Stahl, *The Polarity of Online Reviews: Prevalence, Drivers and Implications*, 57 J. MARKETING RES. 853, 856 (2020); *see also* Nan Hu, Paul A. Pavlou, and Jie Zhang, *Overcoming the J-shaped Distribution of Product Reviews*, 52 COMM. OF THE ACM 144, 145 (2009) (noting that this distribution reflects consumers' tendency to write reviews to "brag or moan").

Further, for some product categories it is difficult to use mean scores to select among items in that category. For instance, a reader looking for a book recommendation would find the mean rating for the 500 books that appeared on one of Amazon's annual bestsellers list during the 2010s to be unhelpful. Amazon reviewers awarded 4.6 out of 5 stars on average to these books, with the rankings tightly clustered around this mean. *See* Sooter Saalu, *Amazon Top 50 Bestselling Books*, Kaggle.com (Oct. 13, 2020), https://www.kaggle.com/sootersaalu/amazon-top-50-bestselling-books-2009-2019 (providing data used by the authors to calculate that, with a standard deviation of 0.2, over two-thirds of bestsellers had a mean rating between 4.4 and 4.8). Only 1.6 stars separate the lowest-rated bestseller, J.K. Rowling's *The Casual Vacancy*, from the 50 bestsellers, mostly children's books and political commentaries, that are tied for the highest mean rating. See id. That bestselling books tend to be well-liked and that readers presumably purchase books that they expect to enjoy, thus self-selecting into the sample of potential reviewers, are both unsurprising.

Nonetheless, in other contexts consumers exhibit a greater tendency to rate products along a broad spectrum, implying that they see value in nuanced ratings in these settings. That is the case concerning book reviews on Goodreads.com. That Goodreads emphasizes a "social cataloging" function rather than promoting purchases may encourage more nuanced rankings. Indeed, whereas ratings on e-commerce sites often include a preponderance of very high and very low ratings, presumably to influence others' consumption decisions, ratings on Goodreads are spread more uniformly across the 1-5 spectrum, with more 2-4 ratings, fewer 1s, and far fewer 5s than on Amazon. Stefan Dimitrov, Faiyaz Zamal, Andrew Piper, and Derek Ruths, *Goodreads versus Amazon: The Effect of Decoupling Book Reviewing and Book Selling*, PROCEEDINGS OF THE INTERNATL. 9 AAAI CONF. ON WEB AND SOCIAL MEDIA 602, 603-04 (2021).

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This variation in individual customers' experiences with banks is not remarkable. Although many crowd-sourced reviews adhere to a J-shaped distribution—with many items rated in the highest category, some rated in the lowest, and the middle categories relatively unpopulated[185]—others exhibit more bell-shaped or uniform distributions. Aggregating ratings across categories on Yelp generates a slightly-skewed bell curve.[186] So do hotels rated on TripAdvisor for some cities[187] and potential romantic partners on OkCupid.[188] Movie ratings on Rotten Tomatoes are spread more uniformly across their entire range.[189]

* * *

This Part has presented two facts. *First*, bank examiners strongly favor assigning CRA scores of *satisfactory* and *outstanding*. Scores in the lowest two categories on the CRA's four-category scale—while never common even in their early 1990s heyday—have become an endangered species. *Second*, this trend has accelerated over time.

The unusual, uninformative distribution of CRA examination scores is not a fait accompli. Other scores on which important stakeholders rely—namely, credit ratings for fixed-income investors and crowdsourced consumer-satisfaction ratings for bank customers—exhibit far greater variation, including larger proportions of negative ratings than CRA examiners are inclined to award. That these measures include more categories than the CRA—with their distributions of scores spread much more uniformly across these categories—means that they allow for more nuanced judgments than are available with the CRA's four categories.

Needless to say, the assessment criteria, assessors, and audiences for CRA scores, S&P credit ratings, and Yelp customer-satisfaction scores differ widely. Yet S&P and Yelp's more numerous categories and greater spread of scores offer lessons

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[185] Hu, et al., *supra* note __, at 145.

[186] *See* Nilesh Dalvi, Ravi Kumar, and Bo Pang, *Para'normal' Activity: On the Distribution of Average Ratings*, Proceedings of the Seventh International AAAI Conference on Weblogs and Social Media, p. 113, 2013. Technically, the curve approaches a log-normal distribution with a low σ value.

[187] Georgios Zervas & Davide Prosperpio, *A First Look at Online Reputation on Airbnb, Where Every Stay Is Above Average*, 32 MARKETING LETTERS 1, 10 (2021) (distributions of TripAdvisor rankings in *some* cities approximating the normal distribution).

[188] Jason Kincaid, *OkCupid Checks Out the Dynamics of Attraction and Your Love Inbox*, Nov. 18, 2009, https://techcrunch.com/2009/11/18/okcupid-inbox-attractive/. Men's ratings of women's attractiveness approximate a normal distribution. Women's ratings of men on the site, by contrast, are skewed towards lower values; women rate 80 percent of male OkCupid users as below average.

[189] Walt Hickey, *Be Suspicious of Online Movie Ratings, Especially Fandango's*, FIVETHIRTYEIGHT, Oct. 15, 2015, https://fivethirtyeight.com/features/fandango-movies-ratings/

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for the CRA. These features demonstrate that important stakeholders—i.e., fixed-income investors for credit ratings and customers with respect to customers - satisfaction scores—can comprehend a more nuanced distribution. Going further, the fact that profit-motivated firms produce these scores shows that these stakeholders *value* more nuanced assessments.[190] Building on these insights, the next Part proposes changes in CRA evaluations that would make the ratings more useful to regulators and the interested public.

III. A REFORM AGENDA

Thus far, this Article has presented evidence and argument that the CRA examination system is broken. Regulators recognize the need for reform. On May 5, 2022, the three federal banking agencies issued a notice of proposed rulemaking to "strengthen and modernize" the CRA.[191] Their nearly seven-hundred page proposed rulemaking covers eight substantive areas of reform across twenty-two separate chapters.[192] The proposal focuses on creating greater variety—arguably, more complexity—in evaluating bank activities and geographies, including by modernizing regulatory relationships with mobile and online banking,[193] treating banks differently according to size and activity,[194] reduce data-porting burdens,[195] and integrating CRA-related complaints and CRA exams.[196]

The proposed rulemaking has little to say about examination outcomes themselves—with two exceptions. *First*, the proposed rulemaking calls for the agencies to take the four existing statutory ratings and turn them into five categories by dividing *satisfactory* into *high satisfactory* and *low satisfactory*.[197] The justification for this change is that it will "allow the agencies to better differentiate very good performance

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[190] Although Yelp's distributed user base, and not the company, determines the ratings that reviewed firms receive, Yelp affirmatively decided to structure its ratings to enable user ratings along an 9-point scale (1-5 stars, in half-star increments).

[191] Office of the Comptroller of the Currency, News Release, Agencies Issue Joint Proposal to Stengthen and Modernize Community Reinvestment Act Regulations, May 5, 2022.

[192] The Notice of Proposed Rulemaking, 12 C.F.R. part 25, RIN 1557-AF15, May 5, 2022, available at https://www.occ.treas.gov/topics/consumers-and-communities/cra/index-cra.html

[193] Id. at § XI

[194] *See, e.g.,* id. at § IX

[195] Id. at § XIX

[196] Id. at § XX

[197] Id. at 149

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from performance at the lower end of the satisfactory range."[198] Given that the most important consequences of CRA examinations occur only for banks in the *needs to improve* and *substantial noncompliance* categories, how, this proposed change is likely to have little impact on bank or regulator behavior.[199]

Second, the proposed rulemaking contemplates that the major components of CRA scores—a *market benchmark* that "reflects the aggregate lending to targeted areas or targeted borrowers by all lenders operating in the same assessment area"[200] and a *community benchmark* that "reflect[s] the demographics of the assessment area"[201]—be calculated using defined percentages.[202] For instance, a bank that is lending at 33 percent of the market benchmark would receive a *needs to improve* rating under the proposed rule (if certain other conditions also are met).[203] This proposed change *might* lead to a larger spread of CRA scores—or it might not. For example, let's say the market benchmark for a given assessment area is $100. If all banks in the assessment area lend engage in at least $33 of CRA-qualified lending in that area, then no bank would receiv a *needs to improve* rating (again, if certain other conditions also are met). Thus, we could observe the same clustering of CRA scores if the proposed rule is finalized.

To achieve its potential, the CRA must operates within a supervisory framework that permits genuine variety in examination outcomes. Unfortunately, the the proposed rulemaking fails to provide that framework. Accordingly, it is an incomplete solution. In order for the prospect of a low score—and the negative consequences that come with it—to meaningfully affect lending behavior, banks must credibly believe that a substandard score is possible if they do not aim high. Given the current distribution of scores, that belief would not be rational.

In response, this Part presents a four-pronged reform agenda. In brief, we propose the following:

- *First*, regulators should strive for a more varied distribution of examination scores. Put plainly, the evaluative scale needs more categories and greater

[198] Id.

[199] There are several other areas in the vast regulatory reform that are promising and relevant to our proposal that we engage below.

[200] Id. at 33,927.

[201] Id. at 33,939.

[202] Id. at 33,942.

[203] Id. at 33,943.

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variance in banks' placement across these categories. We propose one such distribution.

- *Second*, regulators should clearly convey how examination scores affect regulatory outcomes. If high scores are not merely foregone conclusions, banks will recognize that they must compete to achieve these scores—lest they fall short and find themselves unable to expand. Accordingly, regulators should publish clear guidance on how each score would factor into regulators' decisions to approve or deny each type of expansion, so that banks can know what objectives are required of them.

- *Third*, regulators should devote greater efforts to expanding public access to CRA scores. With a national conversation on racial and economic justice ongoing, the conditions are ripe for customers, investors, and employees evaluating banks on their record of redressing inequities in lending.

- *Finally*, to optimize the effectiveness of a mandatory curve, Congress and the banking regulators should close loopholes such that the banks will neither be unduly burdened by a mandatory curve nor able to game the system through regulatory arbitrage as discussed *supra* Part I.C.[204]

In summary, we urge banking regulators to (1) adopt of forced-curve in the generation of CRA examination scores; (2) reform the way regulators use these scores; (3) implement changes in CRA practices that encourage the public's greater use of the scores; and (4) close various loopholes and deficiencies that, if left undisturbed, would further encourage regulatory arbitrage and reduce the benefits of the other three elements. This Part details each of these four elements in turn.

A. Reweighing the Distribution

[204] These implementing proposals consist of (1) redefining "assessment areas" more broadly to avoid gaming the CRA commitments through area selection; (2) closing legislative and regulatory loopholes that present opportunities to avoid and evade CRA responsibilities by changing charter and (3) building on previous work from Michael Klausner to make the sting of our proposals—essentially, the guarantee that some pre-determined quantum of banks will not be able to expand because of poor CRA performance—easier for banks to bear by creating a system of tradeable CRA credits.

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To correct the maldistribution of CRA scores, we propose that examinations be revamped in a two-step process. First, regulators should place banks within one of three equally weighted categories: *below average*, *average*, and *above average*. Second, regulators should retain discretion to identify outliers via the preservation of the *substantial noncompliance* and *outstanding* labels. Essentially, the proposal combines a forced distribution—i.e., one-third of banks must be placed in each of the *below average*, *average*, and *above average* categories—with a discretionary element, namely, that regulators retain discretion to label a subset of *below average* banks as *substantially noncompliant* and a subset of *above average banks* as *outstanding*.[205]

Figure 6 provides an illustration of this scheme. Panel (a) shows the extant distribution of CRA scores. Panel (b) shows how this distribution could be reformatted under our proposal. One-third of banks in Panel (b) are rated *average*; a combined third are rated either *above average* or *outstanding*; and another combined third are rated either *below average* or in *substantial noncompliance*. For ease of comparison, the same proportion of banks are rated *outstanding* (14 percent) and in *substantial noncompliance* (0.55 percent) in both panels.

[205] Because the CRA requires the banking agencies to report ratings based on the four statutory categories – i.e., *outstanding*, *satisfactory*, *needs to improve*, and *substantial noncompliance* – that information also would be reported under our proposal. 12 U.S.C. § 2906(b)(2).

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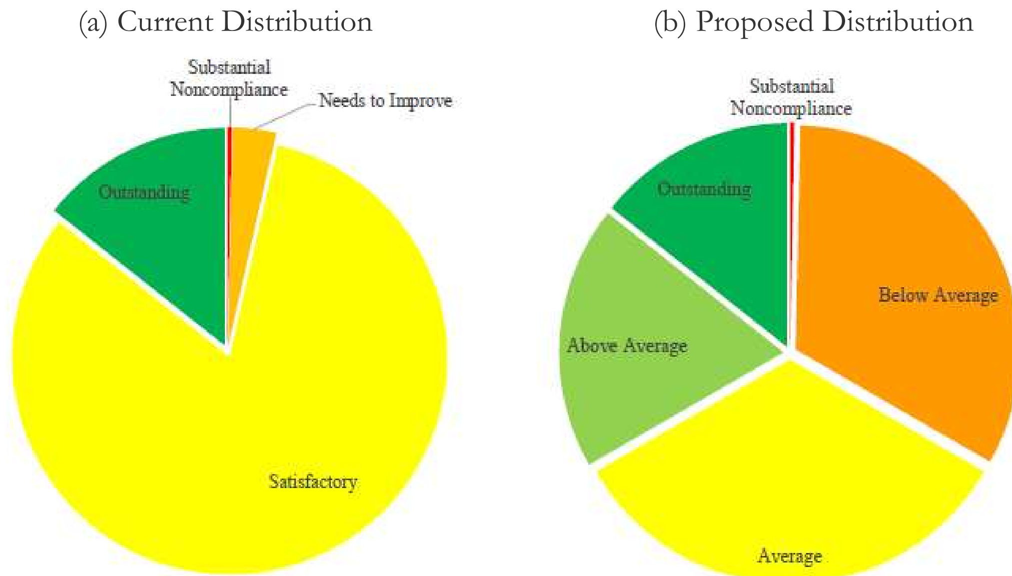
Figure 6: Distribution of CRA Scores



The forced-distribution component—in other words, grading banks on a curve—compels regulators to make tough choices. Whereas a captured or conflict-adverse regulator may succumb to the Lake Wobegon effect, the requirement that regulators sort one-third of banks into each category acts as a constraint. Because the labels *below average*, *average*, and *above average* are descriptive rather than normative, the proposal avoids a common critique with other forced curves: that they may compel the assignment of explicit value judgments to some subjects for which those statements do not apply.

If coupled with clear, objective criteria, forced-distribution rankings can be among the most transparent, meritocratic ways to make employment and compensation decisions.[206] They also compel subjects to focus relentlessly on the stated criteria.[207] A bank cannot rest on its laurels with a forced-distribution ranking.

[206] *See* Goeff Colvin, *A CEO's Passionate Defense of "Stack Ranking" Employees*, FORTUNE, Nov. 19, 2013, https://fortune.com/2013/11/19/a-ceos-passionate-defense-of-stack-ranking-employees/

[207] Naturally, this feature makes the rankings only as good as the performance metrics that are employed.

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If it knows that its competitors are trying to improve their examination scores, that bank must similarly improve lest its ranking slip.[208]

Forced-distribution rankings are prevalent, albeit often controversial, across a variety of settings.[209] Jack Welch, the celebrated former CEO of General Electric, was a prominent proponent of the method to assess the company's executives.[210] When GE's stock price reached the stratosphere in the 1990s and Welch was declared "Manager of the Century,"[211] this management technique was widely imitated.[212] Now that GE has fallen back down the earth, the idea has lost some of its luster.[213] Nonetheless, Amazon and other large, successful companies employ a version of it today.[214]

The downsides of forced-distribution rankings, which are well-known in other contexts, are inapposite here. In the corporate context, forced-distribution rankings can demoralize employees, particularly when coupled with layoffs or other punitive measures. As low performers exit the company, the forced curve requires assigning low rankings to some previously satisfactory performers. That may further lower morale and encourage exit, to the company's detriment.[215]

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[208] *Cf.* Gerald S. Oettinger, *The Effect of Nonlinear Incentives on Performance: Evidence from "Econ 101"*, 84 REV. ECON. & STAT. 509 (2002) (finding that when students are graded on an absolute scale, their grades cluster slightly above the thresholds separating each level).

[209] This method is alternatively referred to as stack ranking, forced ranking, and performance ranking.

[210] See Sarah O'Connor, *Why Ranking Employees by Performance Backfires*, FIN. TIMES, Apr. 6, 2021, https://www.ft.com/content/0691002c-2200-4583-88c9-9c942d534228.

[211] Steve Lohr, *Jack Welch, G.E. Chief Who Became a Business Superstar, Dies at 84*, N.Y. TIMES, Mar. 2, 2020, https://www.nytimes.com/2020/03/02/business/jack-welch-died.html.

[212] *See* Loren Gary, *The Controversial Practice of Forced Ranking*, HARV. MGMT. UPDATE, Oct. 2001, https://hbswk.hbs.edu/archive/for-whom-the-bell-curve-tolls-the-controversial-practice-of-forced-ranking

[213] *See* Bryan Hancock, Elizabeth Hioe, and Bill Schaninger, *The Fairness Factor in Performance Management*, MCKINSEY Q., Apr. 2018, https://www.mckinsey.com.br/~/media/McKinsey/Business%20Functions/Organization/Our%20Insights/The%20fairness%20factor%20in%20performance%20management/The-fairness-factor-in-performance-management.pdf.

[214] *See* Sarah Jackson, *Amazon Reportedly Evaluates its Office Workers with a Tiered System that Targets 6^ of Them Leaving Every Year*, BUS. INSIDER< June 22, 2021, https://www.businessinsider.com/amazon-performance-review-6-percent-of-office-workers-2021-6.

[215] *See* Chintan Vaishnav, Ali Kkakifirooz, and Martine Devos, *Punishing by Rewards: When the Performance Bell-curve Stops Working for You*, http://web.mit.edu/chintanv/www/Publications/Chintan%20Vaishnav%20Punishing%20by%20Rewards%20for%20Publication%20Final.pdf

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Forced-distribution rankings exhibit similar disadvantages in educational settings. According to Professor Adam Grant, grade curves create a "toxic" atmosphere and "hypercompetitive culture" by "pitting students against one another."[216] They also can introduce an element of arbitrariness into evaluations. For instance, if all students in a class have mastered the material, requiring a fraction of them to nonetheless receive failing grades is arbitrary.[217]

These critiques do not apply in the banking context. Criticisms from the personnel-management and education contexts—namely, that forced-distribution rankings facilitate overly competitive behavior, discourage teamwork, and reduce morale for all but the top performers[218]—are plainly irrelevant to community lending. Fierce competition among banks to lend to underserved communities would be a positive development; "teamwork" among banks, or collusion, is illegal; and, put bluntly, the morale of executives at banks that are at the bottom distribution of meeting community lending responsibilities should not be bank examiners' concern. Accordingly, considerations that cut against the use of force-distribution rankings in other contexts are either inapposite or *favor* the use of this technique here.

The second element of our proposal, that regulators retain discretion to label positive outliers *outstanding* and negative outliers *substantially noncompliant*, also brings advantages. The former conveys excellence; the prospect of achieving that distinction may motivate banks to engage in greater lending to underserved communities. The latter term signals a legal failing in language that cannot be captured by reference to the mean; "far below average" does not capture the same sense of failure. Relatedly, economists studying incentive theory have found that increasing the size of the relative difference in "prizes" separating ranks among participants in a tournament is associated with improved performance.[219] Including these two categories with moral valence in our proposed five-point scale would further this aim.[220]

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[216] See Adam Grant, Why We Should Stop Grading Students on a Curve, N.Y. TIMES, Sept. 10, 2016.

[217] Id.

[218] *See* O'Connor, *supra* note __.

[219] *See* Canice Prendergast, *What Happens within Firms? A Survey of Empirical Evidence on Compensation Policies*, in JOHN HALTIWANGER, MARILYN E. MANSER, AND ROBERT TOPEL, EDS., LABOR STATISTICS MEASUREMENT ISSUES 335 (1998).

[220] Even "prizes" that are purely symbolic—here, for instance, if banks do not expect greater revenue based on customers' preference for a bank that performs well on the CRA—they can nonetheless motivate behavior. In an experimental setting, congratulatory cards with purely symbolic value were found to motivate effort. Michael Kosfeld and Suzanne Neckermann, *Getting More Work for Nothing? Symbolic Awards and Worker Performance*, 3 AM. ECON. J: MICROECONOMICS 86 (2011). Even if coldly rational banks as institutions are not motivated by symbolic gestures of this sort, their

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The most obvious alternative scale is a hundred-point range, in other words, that regulators publish each bank's percentile ranking. The knowledge that, for instance, one bank is in the 20th percentile for lending to underserved communities and another bank is in the 90th percentile could motivate consumers to choose the latter bank over the former, particularly where the financial services offered appear essentially interchangeable. That feature, in turn, could spark greater CRA lending among competing banks.

Publishing percentile rankings comes with a price, however. Requiring examiners to rank banks with this level of precision may impose substantial resource costs. If accurate rankings with this degree of specificity are not possible, requiring regulators to generate them anyway would misinform the public and invite judicial invalidation of the scores as arbitrary and capricious.[221] Cognitive constraints among bank customers also counsel in favor of coarser rankings, particularly in situations where customers favor making fast decisions that they perceive as low stakes.[222] Given the costs and benefits of a five-point vs a hundred-point system, or other alternatives still, we offer a five-point scale as a starting point, not as a mandatory last word.

Indeed, in some situations, coarser rankings like our proposed five-point scale may motivate greater effort than would more fine-grained scales. Consider the following scenario. Assume that North Side Bank and South Side Bank are competitors in the Chicago assessment area and each bank wants to outrank the other

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employees may be. Accordingly, high performance on CRA exams may be helpful to attract and motivate employees.

These advantages notwithstanding, a five-point scale is not essential to the success of these proposals, even though such a scale is favored by the banking regulators in their 2022 notice of proposed rulemaking. The optimal number of categories in a scale differs by context, *see* Eli P. Cox III, The Optimal Number of Response Alternatives for a Scale: A Review, 17 J. MARKETING RES. 407, 418 (1980), and we cannot claim that a particular number is best. *See* Eli P. Cox III, *The Optimal Number of Response Alternatives for a Scale: A Review*, 17 J. MARKETING RES. 407, 418 (1980). Other researchers posit that pyramidal distributions—with relatively few subjects being assigned the highest score, more receiving the next-highest score, and so on—optimizes motivation. *See, e.g.*, Alexander Koch, Julia Nafziger, and Helena Nielsen, *Behavioral Economics of Education*, 115 J. ECON. BEHAVIOR & ORG. 3, 11 (2015).

[221] *See* 5 U.S.C. § 706.

[222] *See* Nick Netzer, *Evolution of Time Preferences and Attitudes toward Risk*, 99 AM. ECON. REV. 937 (2009). In other contexts, researchers have found that the information loss associated with moving from fine-grained to coarser ratings is not substantial. *See, e.g.*, Andrew K. Rose, *Is Finer Better? A Master's Investigation into Coarse Grading*, Working Paper, Feb. 18, 2021, http://faculty.haas.berkeley.edu/arose/CoarseG.pdf.

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on its CRA exam.[223] For this example, also assume that CRA examiners assign banks a score along a 1-100 scale, and that South Side Bank's business is concentrated to a greater degree in low-income areas.

If both banks simply offer a loan to anyone who walks into a branch—that is, they exert no additional effort to boost CRA lending per se—South Side Bank can be expected to receive a higher score because more of its branches are in low-income neighborhoods. With some uncertainty over the precise score, assume that South Side Bank will receive a score in the 80s if it does not exert effort and one in the 90s if it does. Similarly, if North Side Bank—which, recall, is located in a more affluent area—does not exert effort, it will receive a score in the 60s versus one in the 70s if it exerts effort. Table 3 displays these expected scores for each bank under both low and high effort.

Table 3: Expected CRA Scores

	South Side Bank	North Side Bank
Low Effort	80-89	60-69
High Effort	90-100	70-79

If each bank cares about its CRA ranking relative to its competitor, neither will exert effort to boost community lending with a 100-point scale. Regardless of whether each bank exerts effort, South Side Bank will come out ahead, with a minimum score of 80. But let's say the scores are clustered into categories: scores above 95 are labeled *outstanding*, those between 67 and 95 are *above average*, and so on. Now, if North Side Bank exerts effort, it can achieve an *above average* ranking—the same ranking that South Side Bank could achieve even if it also exerts effort. That competition in turn prods South Side Bank to exert effort in order to maximize its chances of being rated *outstanding* and thus besting its competitor. In other words, each bank exerts effort to improve its community-lending posture only when scores are clustered into categories.

Needless to say, this outcome is contingent on the numerical values and categories that we set; replacing these figures with others could generate different outcomes. But that's the point. In theory, regulators could design a similar system to

[223] This example draws extensively from Pradeep Dubey and John Geanakoplos, *Grading Exams: 100, 99, 98, . . . Or A, B, C?*, 69 GAMES & ECON. BEHAVIOR 72 (2010); *see also* MICHAEL SPENCE, MARKET SIGNALING: INFORMATIONAL TRANSFER IN HIRING AND RELATED PROCESSES (1974) (introducing signaling and screening models).

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optimally classify banks along a detailed numerical scale and then setting ranges for each corresponding cluster.

B. Expanding the Stakes

Regulators are not only producers of CRA scores; they also are consumers. Because regulatory treatment of banks in several respects hinges on those banks' CRA performance, a larger spread of scores would motivate banks to devote greater resources to community lending.

For one, Congress mandates that regulators "take . . . into account" a bank's CRA assessment when evaluating "a deposit faculty by such institution."[224] Regulations require that the appropriate agency consider "the record of [CRA] performance" when considering a bank's application to open a new branch, merge with another bank, or acquire another bank's assets or liabilities.[225] In order words, before a regulator approves changes to a bank's footprint or balance sheet, the regulator must consider the bank's record of community lending.

Further, if a bank aims to expand into other financial services—for instance, to cross-sell mutual funds, brokerage services, and insurance to their customers—it must achieve at least a *satisfactory* rating on its most recent CRA exam.[226] To create a coveted one-stop "financial supermarket" in the manner of JPMorgan Chase or Citigroup, banks must meet their community-lending obligations.[227]

With the current distribution, these requirements are fairly picayune. The statutory provision that regulators "take . . . into account" CRA scores before authorizing expansion does not elaborate on what exactly regulators are to do with this information. Neither do the associated regulations provide any clarity. That is a

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[224] 12 U.S.C. § 2903(a)(2). Relatedly, the Bank Merger Act allows regulators to approve bank mergers that are anticompetitive if those effects "are clearly outweighed in the *public interest* by the probable effect of the transaction in meeting the convenience and *needs of the community to be served*." 12 U.S.C. §§ 1828(c)(5)(B), 1842(c)(1)(B) (emphases added). That allowance for "the public interest" to trump anticompetitive concerns in merger review makes the Bank Merger Act unique among antitrust statutes. *See* Jeremy C. Kress, *Reviving Bank Antitrust*, 72 DUKE L.J. __, *14 (forthcoming).

[225] 12 C.F.R. § 25.29 (a).

[226] Id. at 2903(c). Technically, this process involves a bank holding company becoming a financial holding company.

[227] *See* Steven Lipin & Stephen E. Frank, *One-Stop Shopping Is the Reason for the Deal*, WALL ST. J., Apr. 7, 1998, at C14 (referring to the newly created Citigroup conglomerate as a "financial supermarket").

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missed opportunity. To the extent that banks respond to the incentives that their regulators provide, establishing clear criteria regarding how CRA evaluations affect banks' ability to expand will spark greater attention to lending to underserved communities.

A wider distribution of examination scores also would discipline regulators. With virtually all banks receiving *satisfactory* or *outstanding* scores, it is impossible for an outsider to assess how seriously regulators treat their mandate to take into account CRA performance in assessing bank expansion applications. By contrast, recall that one third of banks must be rated *below average* under our proposal. If regulators routinely approve expansion requests from banks with this low ranking, that behavior would call into question the extent to which regulators adhere to their mandate to consider CRA performance in evaluating bank expansion proposals. If regulators were to approve expansions by low-rated banks, it is easy to see how that decision would signal an agency asleep at the wheel and spark congressional and media attention.

The statutory mandate that a bank seeking authorization to provide investment banking, insurance, and other non-bank financial services maintain a CRA score of *satisfactory* or above is more definitive.[228] Yet even this requirement falls far short of its potential. That 96 percent of banks during our study period met this requirement suggests that the bar has been set far too low. As an alternative, the CRA could be amended to require banks seeking to create or join a multi-line financial holding company to achieve a CRA score at or above the median. Although that threshold is

[228] The requirement is contained in a 1999 law authorizing regulators to approve affiliations among commercial banks, investment banks, and insurance companies under certain conditions. Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) § 103(b) (codified at 12 U.S.C. § 2903(c)(1)). That law constituted a sea change; for most of the twentieth century, such combinations had been prohibited pursuant to the Glass-Steagall Act. *See* Jeremy C. Kress, *Solving Banking's "Too Big to Manage" Problem*, 104 MINN. L. REV. 171, 206 (2019). "[T]he objective" of that legislation, according to a House committee report, was "to enhance the ability of financial institutions to meet the capital and credit needs of the communities in which they operate, *including underserved communities and populations*." H.R. REP. NO. 106-74, pt. 1, at 97 (1999) (emphases added). Regulators had eroded some of the dividing lines between these securities, insurance, and banking functions prior to 1999. *See* Conti-Brown and Feinstein, *supra* note __, at 192. Essentially, the claim is that not only would underserved communities benefit from allowing the nation's largest financial institutions to break down the Depression-era wall separating commercial banks, investment banks, and insurance companies, but this was the measure's *purpose*. *See* Kress, *supra* note __, at 206 (describing the status quo ante under the Glass-Steagall Act).

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not particularly onerous, it could motivate lending to underserved communities to a much greater extent than the current standard.

C. Publicizing the Scores

In recent years, the Black Lives Matter social movement and a related cultural shifts have placed issues of racial equity front and center in a national conversation,[229] including in debates over financial regulation.[230] Regulators should seize the moment. With racial and economic justice concerns arguably more salient now than in decades, regulators should provide greater information to the public concerning banks' lending practices to underserved communities.

To be sure, some CRA information already is available. FFIEC provides an online search function enabling users to view CRA scores based on bank name, location, and other fields.[231] Interested users can also view bank-level disclosure reports with detailed information concerning bank lending aggregated by income bracket. The Federal Reserve compiles information from these reports into massive downloadable spreadsheets, with thousands of rows, each corresponding to a financial institution, and hundreds of columns, most of which report various facets of the bank's lending activity.[232]

These disclosures are in keeping with the CRA's purpose. CRA rests in part on the idea that banks and regulators have information that is relevant to third parties—e.g., community leaders, potential borrowers, and interested citizens—but that such information is not otherwise accessible to them. Accordingly, the statute calls for regulators to generate that information via a specialized examination and, following

[229] *See* Larry Buchanan, Quoctrung Bui, and Jugal K. Patel, *Black Lives Matter May Be the Largest Movement in U.S. History*, N.Y. TIMES, July 3, 2020, https://www.nytimes.com/interactive/2020/07/03/us/george-floyd-protests-crowd-size.html.

[230] *See, e.g.*, Keeva Terry, *Black Assets Matter*, 57 TULSA L. REV. 197 (2022); Race and Regulation Lecture Series, Penn Program on Regulation, 2021-22, https://www.pennreg.org/race-and-regulation/; Christopher Brummer, *What Do the Data Reveal about (the Absence of) Black Financial Regulators?* Brookings Working Paper, Sept. 2, 2020; Mehrsa Baradaran, *Rethinking Financial Inclusion: Designing an Equitable Financial System with Public Policy*, Roosevelt Institute Working Paper, Apr. 2020.

[231] Federal Financial Institutions Examination Council, Interagency CRA Rating Search, https://www.ffiec.gov/craratings/default.aspx.

[232] Board of Governors of the Federal Reserve System, CRA Analytics Data Tables, https://www.federalreserve.gov/consumerscommunities/data_tables.htm. Most of these columns contain information from CRA exams and Home Mortgage Disclosure Act reports.

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the statute's overhaul in 1989,[233] to provide the results to the public.[234] According to Michael Barr, this public disclosure "harnesse[s] the power of public relations to CRA's goals."[235]

The content and format of these disclosures, however, can be substantially improved. For one, with the scores so tightly concentrated towards the upper end of the distribution, there is little basis for outside parties to use FFIEC's reporting of stand-alone CRA scores to assess banks' performance relative to their competitors. Regulators should not expect individuals to spend resources accessing CRA scores only to learn that their bank is among the 96 percent of financial institutions that meets or exceeds regulators' standards.

More fundamentally, the publicly available information is simply not useful to non-experts in its current form. Although the Federal Reserve should be commended for placing so much information from CRA reports into a searchable spreadsheet, the complexity of this spreadsheet and the lack of clarity regarding which variables matter most makes this project less useful. Clearly, these data were intended for dedicated empirical researchers rather than interested laypeople.

Financial regulators should supplement these efforts with an intuitive, user-friendly online resource. We envision a website—call it, say, communitylending.gov—where users could enter a bank's name into a search field and view not only the bank's grade on its most recent CRA exam, but also its share of lending to low-income communities, how that share compares to other banks, and whether its community-lending posture is improving or declining over time. This approach would provide a gauge of how the bank compares to its peers without overwhelming users with a mass of undifferentiated information.

Given the heightened salience of racial equity, we expect that more easily accessible CRA information could capture the attention of activists, community leaders, and other engaged members of the public. For instance, one could envision social media campaigns encouraging or discouraging individuals from patronizing banks with outlying scores. Given the substantial growth in investment funds that focus on socially responsible companies, investors also could benefit from more

[233] *See supra* Part I.C.

[234] 12 U.S.C. § 2906(b). Nonetheless, some portions of these CRA examination reports must remain confidential. Id. at § 2906(c).

[235] Michael S. Barr, Credit Where It Counts: The Community Reinvestment Act and Its Critics, 80 N.Y.U.L. REV. 513, 524 (2005).

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accessible community-lending information.[236] Similarly, high CRA scores could help attract and motivate employees who care about corporate social responsibility.[237]

We are confident that, although most customers would not use this information, a large enough subset would do so such that the scores and their accessibility would have the desired impact. After all, many Americans have become accustomed to online product ratings during the past several decades.[238] Commercially produced ratings add value in a wide variety of settings. For instance, sharing-economy firms like Uber have reached multi-billion dollar valuations in part based on their incorporation of crowd-sourced ratings.[239]

Consumers are sophisticated users of crowd-sourced ratings. For instance, a one star increase in an independent restaurant's rating on Yelp causes a 5-9 percent increase in revenue on average.[240] Similarly, an increase in a hotel's mean rating on crowd-sourced travel websites is positively correlated with increased demand, particularly for independent hotels.[241]

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[236] *See* Quinn Curtis, Jill E. Fisch, and Adriana Z. Robertson, *Do ESG Mutual Funds Deliver on Their Promises?*, Law Working Paper No. 586, Eur. Corp. Gov. Inst., June 2021, at 12 (reporting that investments in funds using ESG criteria has doubled between 2016 and 2020).

[237] *See* David A. Jones, Chelsea R. Willness, and Sarah Madey, *Why Are Job Seekers Attracted by Corporate Social Performance?*, 57 ACAD. MGMT. J. 383 (2014) (empirical support for the claim that CSR metrics influence employee recruitment); Abagail McWilliams and Donald Siegel, *Corporate Social Responsibility: A Theory of the Firm Perspective*, 26 ACAD. MGMT. REV. 117 (2001) (positive theory).

[238] See Michael Luca and Georgios Zervas, Fake It Till You Make It: Reputation, Competition, and Yelp Review Fraud, 62 MGMT. SCI. 3412 (2016).

[239] Consider ride-share platforms Uber and Lyft. As children, we were told not to accept rides from strangers. To overcome this sensible warning, ride-share platforms publish averages of user-submitted ratings for their drivers. Potential passengers then use these ratings to decide whether a given driver is trustworthy and reliable when weighing whether to accept a ride. *See* M. TODD HENDERSON & SALEN CHURI, THE TRUST REVOLUTION: HOW THE DIGITIZATION OF TRUST WILL REVOLUTIONIZE BUSINESS AND GOVERNMENT 114 (2019). Drivers utilize similar ratings concerning potential passengers. Customers have endorsed this system; Uber and Lyft have a combined valuation of $70 billion, and their platforms have decimated the taxi industry in many cities. *See* Susan Carpenter, *Los Angeles Rethinks Taxis as Uber and Lyft Dominate the Streets*, N.Y. TIMES, Jan. 12, 2020, https://www.nytimes.com/2020/01/12/business/los-angeles-taxis-uber-lyft.html (describing the platforms' impact on the Los Angeles taxi industry) Google Finance, last accessed Mar. 4, 2022 (report these firms' market valuations).

[240] Michael Luca, *Reviews, Reputation, and Revenue: The Case of Yelp.com*, HARV. BUS. SCH. WORKING PAPER 12-016 (2011), at 4, https://www.hbs.edu/ris/Publication%20Files/12-016_a7e4a5a2-03f9-490d-b093-8f951238dba2.pdf. By contrast, ratings increases for chain restaurants have essentially no impact on revenue, presumably because restaurant-goers already have views on the McDonalds and Cheesecake Factories of the world and thus do not need additional information. Id.

[241] Gregory Lewis and Georgios Zervas, *The Supply and Demand Effects of Review Platforms*, 2019, https://people.bu.edu/zg/publications/reviews-supply-demand.pdf

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Ratings by authoritative actors—like regulatory agencies, presumably—may carry particular weight. Consider that an additional one review by a Yelp-designated "elite" reviewer has almost double the effect on the reviewed business's revenue than a review by someone without this designation.[242] The greater effect of "elite"-labeled reviews on revenue shows that Yelp's authoritative seal of approval matters.

To capitalize on consumers' affinity for ratings, regulators could design a voluntary branding initiative. The federal government's Energy Star program provides a template. Jointly administered by the Department of Energy and Environmental Protection Agency, the program rates appliances and electronic equipment, from refrigerators to traffic lights, for their energy efficiency.[243] Products that meet the program's standards may display the Energy Star logo on their packaging.

Energy Star is a success. Over 90 percent of Americans recognize the program's logo.[244] Consumers report that they are willing to pay substantial premiums for home appliances displaying the symbol, in part because of their environmental benefits.[245] Allowing high-scoring banks to advertise that status by displaying uniform branding could have a similar effect, leading some banks looking to attract customers concerned about racial and economic justice to boost their lending to underserved communities essentially as a marketing strategy.

D. Complementing the Proposal

Many would-be reformers have proposed legislative and regulatory fixes for these issues.[246] Indeed, the banking regulatory agencies' May 2022 proposed

[242] Id. at 5.

[243] See Marla C. Sanchez, Richard E. Brown, Carrie Webber, and Gregory K. Homan, Savings Estimates for the United States Environmental Protection Agency's ENERGY STAR Voluntary Product Labeling Program, 36 ENERGY POL'Y 2098 (2008).

[244] Environmental Protection Agency, National Awareness of ENERGY STAR for 2019: Analysis of 2019 CEE Household Survey, 2000, https://www.energystar.gov/sites/default/files/asset/document/National_Awareness_of_ENERGY_STAR_2019_DNVGL_050120_508.pdf

[245] *See* David O. Ward, Christopher D. Clark, Kimberly L. Jensen, Steven T. Yen, and Clifford S. Russell, *Factors Influencing Willingness-to-Pay for the ENERGY STAR Label*, 39 ENERGY POL'Y 1450 (2011). Perceived lower energy costs over the appliance's life also is a factor. *See id.*

[246] *See, e.g.*, National Community Reinvestment Coalition, *Position Paper on CRA Reform*, March 1, 2022, available at https://www.ncrc.org/position-paper-on-cra-reform/ ; Lael Brainard, *Strengthening the CRA To Meet the Challenges of Our Time*, Speech before the Urban Institute, Washington DC, September 21, 2020.

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rulemaking is itself a wholesale regulatory overhaul. Without also implementing a more rigorous grade distribution, however, these changes would be pulled punches. Any regulatory scheme must include a credible promise of rewards for compliance or a credible threat of sanctions for noncompliance. Accordingly, to tinker with CRA examination criteria without also committing to a more rigorous grade distribution, and thus a heightened probability of sanctions, would be a missed opportunity.

At the same time, implementing curved grading without *also* addressing these other pathologies would be ineffectual. As detailed *infra* Part I.D, the status quo regulatory regime includes several obvious opportunities for regulatory arbitrage and other forms of gamesmanship.[247] Because our proposal would raise the bar for CRA examinations, it also would provide lenders with additional incentives to utilize these strategies to minimize or avoid the CRA.

Accordingly, as a complement to our curved-grading proposal, we offer three reforms to prevent or discourage the use of these strategies. *First*, banking regulators should redefine the "community lending" needed to satisfy the CRA on a national basis, rather than confined to a more limited geographic area. *Second*, Congress should subject all lending institutions—community banks, fintech firms, and credit unions alike—with assets of $100 million or more to CRA lending standards. *Finally*, regulators should create a system of tradeable CRA credits that facilitate the development of CRA expertise, as first proposed by Michael Klausner in 1994.[248] Adopting a national geographic assessment area and placing all lenders under the CRA's umbrella both would eliminate possibilities for regulatory arbitrage. Creating a system of tradeable CRA credits would prevent these reforms from being overly

[247] Recall that Part I.D highlighted three of these features: (i) a fragmented financial regulatory system that encourages charter-shopping by financial institutions and a concomitant "race to the bottom" posture among regulators; (ii) CRA assessments that are based on locations of a bank's facilities rather than that bank's loans, thus encouraging banks to emphasize online lending that lies largely outside of the CRA's perimeter; and (iii) the exemption from CRA coverage of growing categories of lenders—credit unions, non-depository institutions like mortgage lenders, and the like—which places these less regulated entities at an advantage vis-à-vis banks and encourages the mitigation of capital to them.

[248] See Michael Klausner, Letting Banks Trade CRA Obligations Would Offer Market-Based Efficiencies," AM. BANKER (1994); see also Michael Klausner, A Market-Oriented Reform Proposal for the Community Reinvestment Act, 143 U. PA. L. REV. 1561 (1995). Klausner developed these ideas further in 15 years later in Klausner, A Tradeable Obligation Approach to the Community Reinvestment Act, in REVISITING THE CRA: PERSPECTIVES ON THE FUTURE OF THE COMMUNITY REINVESTMENT ACT (2009).

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punitive system and enable even banks with poor community-reinvestment records to expand access to credit.[249]

1. *Redefining Community*

As mentioned above, regulators evaluate CRA lending based on an assessment area that is defined with reference to the bank's physical facilities, which are not necessarily where its borrowers live or their secured property is situated. Remarkably, the CRA does not define the relevant "community" to which the statute applies.[250] Regulations create "assessment areas" that examiners use to evaluate compliance with the statute.[251] These areas are defined as the metropolitan statistical areas or "political subdivisions" in which the bank's "main office, branches, and deposit-taking automatic teller machines (ATMs) are located, as well as the surrounding geographies (i.e., census tracts) where a substantial portion of its loans are originated or purchased."[252]

This definition presents an invitation for arbitrage. Banks can establish their footprint in places where credit risks are low and lending opportunities clear.[253] In the extreme, a bank that is resistant to CRA lending could shrink its physical footprint while continuing to market and originate loans in a much larger area via online lending, and be held responsible only for serving low-to-moderate income borrowers within an assessment area based on its narrow physical footprint. The result is the very definition of a banking desert: banks that are in higher-income areas ignore lower-income areas in an absolute sense. Further, that online lenders and fintech firms can lend nationwide without being subject to the CRA presents an additional opportunity for arbitrage.

By raising the costs to banks of CRA compliance, our curved grade distribution presumably would increase the incentives for banks to engage in geographic arbitrage.

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[249] Note that the first and third proposals, like the grading-on-a-curve proposal generally, can be accomplished via regulation. The second reform, by contrast, requires legislation.

[250] The closest the statute comes to a definition is to instruct regulatory agencies to evaluate the bank's record in meeting the credit needs of the bank's "entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of such institution, and to take such record into account in its evaluation of an application for a deposit facility by such institution." 12 U.S.C. § 2903(a).

[251] 12 C.F.R. § 25.41

[252] NPRM at 13.

[253] Doing so also would obviate the first-mover problems that Fed Chair Ben Bernanke identified as a major barrier to lending to underserved populations. *See* Bernanke, *supra* note __.

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It also presumably would accelerate the transfer in market share from CRA-covered banks to other types of lenders that are exempt from the law. Accordingly, changes to the current definition of assessment areas would be even more pressing if our proposal is adopted.

Recognizing this concern, the regulators' 2022 proposed rulemaking aims to adjust this definition. In an effort to "comprehensively establish the local communities in which a bank is evaluated for its CRA performance," the proposal seeks to modify banks' CRA footprints.[254] Overall, however, the proposed changes are relatively minor. Under their proposal, banks still would retain the ability to define their assessment areas, based primarily on where the bank's facilities are geographically located.[255] For large banks, this assessment area *can* be extended to other kinds of activities—mobile banking, for example—but the bank, not its regulator, retains that definitional capacity. Under the proposed reforms, banks can "receive consideration for qualifying activities conducted nationwide" in new assessment areas, called "areas for eligible development activity."[256]

The main problem is that the ability to select assessment areas is the very ability to select these areas strategically. Whatever the nature of "community" lending in 1977, 1989, or 2005, in 2022, the problems of disintermediation in underserved areas are not uniform. This heterogeneity indicates that the solution for community reinvestment is one that targets—on a national scale—those areas of the United States that are most affected by disinvestment.

Accordingly, we favor a nationwide assessment area. Such a redefinition would remove banks' ability to define their geographic footprints, and thus eliminate the possibility that banks would do so strategically. It would make it so that banks in the highest income ZIP codes have a comparable CRA lending obligation as those in the lowest. Essentially, this change would equalize lending responsibilities and remove the first-mover disadvantage in CRA lending across national institutions.

2. *A Level Playing Field for All Financial Institutions*

Second, that the CRA applies to banks but not to other lenders—e.g., the growing credit-union sector, non-bank mortgage lenders, which includes several

[254] NPRM § VI, page 120.
[255] *Id.*
[256] *Id.*

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leading firms, and emerging fintech lenders[257]—subjects entities engaged in broadly similar functions to markedly different regulatory regimes. That situation is an invitation to regulatory arbitrage.

Naturally, there are some limits to such strategic behavior. For instance, a megabank could never meet the "common bond" requirement among its members to transform into a credit union. Nonetheless, policymakers should be concerned about the CRA's differential treatment of different types of financial institutions regardless whether they see regulatory arbitrage as problematic. That is because mortgage-lending capital over the past several decades has flown out of national- and state-chartered banks and into entities that are exempt from the CRA (and subject to lighter regulation in general).[258] Because our proposal would increase the rigor of CRA examinations, it presumably would accelerate to this trend.

Accordingly, we recommend leveling the playing field by subjecting all lenders to CRA obligations, albeit with some limited adjustments based on asset size but not on charter or capital structure. This change would require legislative action, since credit unions are not considered "insured depository institutions," and thus are not currently subject to CRA coverage.[259] Credit unions justify their separate treatment because their capital structure and business model involve service to more limited populations.[260] But with more and more credit unions building wide-ranging customer bases, the exemption from CRA coverage can invite more regulatory arbitrage.

Indeed, placing credit unions above a certain asset threshold under the CRA's coverage is particularly crucial. Although the median size of a credit union is $35 million, each of the five largest has over $16 billion in assets.[261] Navy Federal Credit Union—the largest, with $111 billion in assets—is large enough to be considered potentially systemically important and subject to a very different regulatory and

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[257] Technically, the CRA does apply to some online-only lenders in the fintech space. Lacking branches and ATMs, these firms' assessment areas typically are limited to the area in which they are headquartered; that regulatory feature practically invites strategic behavior when these firms select the location of their offices.

[258] *See* Lux and Greene, *supra* note __.

[259] *See* 12 U.S.C. § 2902 (section of the CRA that defines application to "insured depository institutions"); 12 U.S.C. § 1813 (defines "insured depository institutions" to exclude credit unions).

[260] For instance, whereas the median asset size of a community bank is $241 million, the median asset size of a credit union is $35 million. *Biggest U.S. Credit Unions by Asset Size*, MX BLOG, April 22, 2021, available at https://www.mx.com/blog/biggest-us-credit-unions-by-asset-size/. For a historical overview of these debates, see C. Blythe Clifford, *The Community Reinvestment Act & Credit Unions*, 4 N.C. BANKING INST. 607 (2000).

[261] Biggest U.S. Credit Unions, supra note ___.

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supervisory climate if it were a bank.[262] It defies logic that these bank-sized credit unions and other non-bank lenders should be exempt from the CRA's requirement that lenders extend credit throughout their communities—and thus enjoy a competitive advantage vis-à-vis banks that *are* subject to the CRA.

To make these standards truly equal, though, there would have to be some regulatory relaxation on the asset side of credit unions' balance sheets. If community banks can satisfy their CRA lending requirements without reference to a "common bond" among members, then this will give them an unfair advantage relative to credit unions. We think that these concerns can be mitigated by making CRA credits divisible and tradeable between credit unions and community banks, as described below.

To be clear, the exclusion of credit unions from the CRA regulatory framework is not solely for purposes of regulatory arbitrage, or because credit union lobbyists are more effective than bank lobbyists. Indeed, at times credit unions have argued *in favor of* CRA application.[263] The point is that the potential for arbitrage is present. Credit unions and other nonbank lenders should be brought into the regulatory perimeter where their lending activities are similar to those of banks.[264]

3. Tradeable Credits

Basing CRA evaluations on a nationwide assessment area may mean that a greater number of institutions falls short on their CRA obligations. Consider, for instance, two regional banks: one with its headquarters, branches, and ATMs in the San Jose metro area, which is one of the wealthiest metropolitan areas in the nation, and the other with its facilities in the Laredo, Texas, metro area, which is one of the poorest.[265] With both banks expending equal effort to lend to underserved populations, the Laredo bank is likely to achieve greater success. Phrased another way,

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[262] *Id.* Under Dodd-Frank, as originally passed in 2010, banks with assets larger than $50 billion were considered of greater risk to the financial system and required a different regulatory and supervisory treatment. See, e.g., 12 U.S.C. § 5331. In 2017, Congress amended to law to change the threshold to $100 - $250 billion. See, e.g., 12 U.S.C. § 5365.

[263] *See* Clifford, *supra* note __.

[264] Defining the appropriate thresholds—viz. asset sizes, lending activities, assessment areas, or other such constructs—for credit unions and other non-bank lenders to be subject to the CRA is nontrivial. It also is not necessary to make the primary argument in this Article, which is that CRA exams should be harder and the regulatory evasion of such requirements harder, too.

[265] *See* Bureau of Economic Analysis, Department of Commerce, *Personal Income by County, Metro, and Other Areas*, Nov. 16, 2021, https://www.bea.gov/data/income-saving/personal-income-county-metro-and-other-areas.

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the marginal cost of originating one additional loan to a lower-income borrower may be higher for the San Jose bank. If banking regulators adopt our curved-grading proposal *and* move to a nationwide assessment area, as we also propose, those developments would yield a markedly lower CRA score for the San Jose bank.

Rather than the San Jose bank expending substantial resources to chase a more limited set of opportunities for CRA lending, the more efficient solution may be for it to cross-subsidize the Laredo bank. The concept of tradeable "CRA credits" would allow these trades to occur, thus allowing banks in the aggregate to squeeze the most CRA-eligible loans out of a set amount of resources.

This idea originates with Michael Klausner, who proposed establishing a "cap-and-trade" system—which derives its name from a similar proposal to reduce carbon emissions—into the CRA system.[266] Under this system, every relevant financial institution would be subject to CRA lending requirements that could be satisfied either through lending or buying credits generated by other financial institutions that had gained expertise in this area.[267]

Professor Klausner constructs an informal model of CRA lending based on the information costs associated with separating low-risk and high-risk borrowers.[268] He discusses these ideas in the context of informational asymmetries as a kind of market failure, but the asymmetry is not between the more knowledgeable banks and the less informed consumers. The asymmetry is the one at the heart of all credit underwriting: whether a lender with a limited history on a given borrower can price credit well enough to recoup the costs of credit.

When banks lack sufficient certainty to accurately price credit to borrowers with whom they are unfamiliar (e.g., because of decades of neglecting these potential customers), the result of this failure leaves "creditworthy borrowers in low-income neighborhoods without access to credit or with less access than they would have if markets worked perfectly."[269] The CRA can be viewed as a response to this market failure. According to Professor Klausner, however, that response is suboptimal because it "leads banks to incur redundant costs in seeking creditworthy borrowers in

[266] *See* Klausner, *supra* note __.

[267] Id.

[268] Id. at 1569. Klausner's discussion explicitly removes from consideration the role of discrimination in lending, not because he does not believe there is racial discrimination is a causal factor in community disinvestment, but because he thinks the CRA—a "model in ambiguity", *id.* at 1561—is "poorly suited to the task of combatting discrimination". *Id.* at 1563.

[269] Id. at 1571

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low-income neighborhoods" and "impedes individual banks from economizing on information costs because [the CRA] deters specialization."[270]

Tradeable credits are Klausner's answer. To accomplish this change—which may be achievable without new legislation[271]—each bank would be given a "quota of CRA-qualified loans."[272] Second, "banks would be given several options regarding how to meet this quota, including the option of transferring it, or a portion of it, to another lender."[273]

Implementing a system of tradeable CRA credits would generate four major benefits. *First*, it would provide a financial incentive for a subset of banks to develop expertise in underserved lending. Banks possessing this comparative advantage—presumably, those with a larger presence in lower-income areas—scan then sell their "excess" CRA lending to other banks that lack such expertise.

Second, it would facilitate a net increase in CRA-relevant lending throughout the system at levels that regulators can easily tweak. If there is excess lending in the system, regulators can drop the requirements such that the credits become less valuable. When there is too little lending, regulators can increase requirements and make the credits more coveted.

Third, it would create much more informational content for consumers, banks, and especially bank supervisors to understand how and when community reinvestment is successful, and how and when it is not. Banks that run a brisk business in selling their credits would address an important social problem *and* make a tidy profit doing so. That profit would provide an important motive to potential competitors to study and replicate their methods.

Finally, for our purposes, a tradeable credit system established alongside a mandatory grade curve will provide a path for banks that fail to meet their now-onerous CRA obligations to nonetheless acquire new deposit facilities. Our proposal would be indifferent between banks that lend to low- or moderate-income neighborhoods and those that pay others for the same amount of qualified lending.

[270] Id. at 1574

[271] Klausner argues that these changes would require legislation, *See* id. A potential path for regulators to implement this proposal without congressional involvement, however, exists. The CRA requires regulators to "assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods" and to "take such record into account in its evaluation of an application for a deposit facility by such institution." 12 U.S.C. § 2903. By rulemaking, the banking regulators can clarify that the purchase of tradeable credits will satisfy the lending assessment required by statute as the record evaluated in passing on the application for a deposit facility.

[272] Klausner, *supra* note __, at 1580.

[273] Id.

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The point would be to increase the net amount of qualified lending to remedy the problems of redlining and community disinvestment. In this way, tradeable credits thus make it possible for financial institutions to participate fully in the work of CRA lending without making that work an insurmountable barrier to their other activities.

CONCLUSION

The time has come to overhaul CRA evaluations. Bank examiners' comfort with 96 percent of banks' community-lending performance flies in the face of a reality in which access to capital remains highly stratified by income.[274] The lack of variation in CRA scores provides their users with a dull instrument. Regulators charged, in evaluating banks' applications for growth, with assessing those banks' community-investment efforts receive little guidance from the current distribution of scores.[275] Likewise, without meaningful variation in these scores, their congressionally mandated publication provides few benefits to community groups and members of the public.[276]

It does not have to be this way. From investors who rely on S&P credit ratings to retail customers interested in their local bank branch's Yelp rating, financial-services stakeholders produce and utilize evaluative measures with far greater nuance than CRA scores. Regulators should now do the same.

Implementing a mandatory curve in isolation, however, would be inadequate. Without companion reforms to eliminate arbitrage and allow for CRA specialization, more rigorous examinations would encourage regulatory gamesmanship by some financial institutions and yield unfair outcomes for others. Adopted as a package, therefore, these reforms would enable the CRA's promise to be better realized. To make headway on redressing societal inequalities through expanded access to financial services for lower-income and minority borrowers, CRA examination outcomes must be made less equal.

[274] *See, e.g.*, Drew Dahl and Michelle Franke, *Banking Deserts Become a Concern as Branches Dry Up*, FED. RES. BANK OF ST. LOUIS, July 25, 2017, https://www.stlouisfed.org/publications/regional-economist/second-quarter-2017/banking-deserts-become-a-concern-as-branches-dry-up (reporting that 3.7 million Americans live in "banking deserts," without no bank branch without a 10-mile radius of their census tract's center, and that these tracts are disproportionately lower-income).

[275] *See* 12 U.S.C. § 2903(a) (mandating that regulators evaluating banks' applications for new deposit facilities "assess the institution's record of meeting the credit needs of its entire community").

[276] *See* id. at § 2906(b) (mandating publication).

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